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Regulations

TITLE 16—COMMERCIAL PRACTICES

Chapter I—Federal Trade Commission

[Docket No. 4756]

PART 3—DIGEST OF CEASE AND DESIST ORDERS

CHARBOY PRODUCTS, INC.

§ 3.6 (t) *Advertising falsely or misleadingly—Qualities or properties of product:* § 3.6 (x) *Advertising falsely or misleadingly—Results.* In connection with offer, etc., respondent's "Cuproloid" or any other similar medicinal preparation, and among other things, as in order set forth, disseminating, etc., any advertisements by means of the United States mails, or in commerce, or by any means, to induce, etc., directly or indirectly, purchase in commerce, etc., of respondent's preparation which advertisements represent, directly or through inference, (1) that respondent's preparation is a cure or remedy for pimples, acne, surface ulcers, skin bruises, insect bites, burns from heat and chemicals, poison ivy, and sunburn or that it has any therapeutic value in the treatment of said diseases or conditions; (2) that respondent's preparation possesses sterilizing or healing properties or that its use will keep the skin healthy; and (3) that respondent's preparation has any therapeutic value in the treatment of athlete's foot, ringworm, or eczema in excess of slightly deterring the growth of fungi with which it comes in contact; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec 45b) [Cease and desist order, Charboy Products, Inc., Docket 4756, January 20, 1944]

§ 3.6 (l) *Advertising falsely or misleadingly—Endorsements, approval and testimonials:* § 3.6 (ee 5) *Advertising falsely or misleadingly—Tests and investigations:* § 3.18 *Claiming endorsements or testimonials falsely.* In connection with offer, etc., of respondent's "Cuproloid" or any other similar medicinal preparation, and among other things, as in order set forth, disseminating, etc., any advertisements by means of the United States mails, or in commerce, or by any means, to induce, etc., directly or indirectly, purchase in commerce, etc., of respondent's preparation, which advertisements represent, directly or through inference, that respondent's preparation has been scientifically tested and approved by competent medical authorities or has been prescribed for use by the medical profession; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Charboy Products, Inc., Docket 4756, January 20, 1944]

At a regular session of the Federal Trade Commission, held at its office in the city of Washington, D. C., on the 20th day of January, A. D. 1944.

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of the respondent, and a stipulation as to the facts entered into between the respondent herein and Richard P. Whitely, Assistant Chief Counsel for the Commission, which provides, among other things, that without further evidence or other intervening procedure, the Commission may issue and serve upon the respondent herein findings as to the facts and conclusion based thereon, and an order disposing of the proceeding, and the Commission having made its findings as to the facts and conclusion that said respondent has violated the provisions of the Federal Trade Commission Act:

It is ordered, That the respondent, Charboy Products, Inc., a corporation, its officers, representatives, agents, and employees, directly or through any corporate or any other device in connection with the offering for sale, sale, or distribution of its medicinal preparation designated "Cuproloid", or any other medicinal preparation of substantially similar

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FEDERAL REGISTER

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composition, or possessing substantially similar properties, whether sold under the same name or any other name, do forthwith cease and desist from:

1. Disseminating or causing to be disseminated any advertisement by means of the United States mails or by any means in commerce as "commerce" is defined in the Federal Trade Commission Act, which advertisement represents, directly or through inference:

a. That respondent's preparation is a cure or remedy for pimples, acne, surface ulcers, skin bruises, insect bites, burns from heat and chemicals, poison ivy, and sunburn or that it has any therapeutic value in the treatment of said diseases or conditions;

b. That respondent's preparation possesses sterilizing or healing properties or that its use will keep the skin healthy;

c. That respondent's preparation has any therapeutic value in the treatment of athlete's foot, ringworm, or eczema in excess of slightly deterring the growth of fungi with which it comes in contact;

d. That respondent's preparation has been scientifically tested and approved by competent medical authorities or has been prescribed for use by the medical profession.

2. Disseminating or causing to be disseminated any advertisement by any means for the purpose of inducing, or which is likely to induce, directly or indirectly, the purchase in commerce as "commerce" is defined in the Federal Trade Commission Act, of respondent's preparation, which advertisement contains any of the representations prohibited in Paragraph 1 hereof.

It is further ordered, That the respondent shall, within sixty (60) days after service upon it of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which it has complied with this order.

By the Commission.

[SEAL] OTIS B. JOHNSON, *Secretary.*

[F. R. Doc. 44–1586; Filed, February 1, 1944; 11:27 a. m.]

[Docket No. 4891]

PART 3—DIGEST OF CEASE AND DESIST ORDERS

S. FRIEDMAN & SONS, ETC.

§ 3.6 (c) *Advertising falsely or misleadingly—Composition of goods*: § 3.66 (a 7) *Misbranding or mislabeling—Composition*: § 3.6 (a) *Using misleading name—Goods—Composition.* In connection with offer, etc., in commerce, of knitting yarns, and among other things, as in order set forth, (1) Using the words "wool", "Tweed", or "worsted", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool; (2) using the word "Shetland", or any simulation thereof, either alone or in connection or

conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool of Shetland sheep grown on the Shetland Islands or the contiguous mainland of Scotland; and (3) using the word "Angora", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of hair of the Angora goat; prohibited; subject to respective provisions, however, as respects aforesaid prohibitions that (1) in the case of a product composed in part of wool and in part of other fibers or materials, words "wool", "tweed" and "worsted" may be used; and (2) in the case of a product composed in part of Shetland wool and in part of other fiber; and (3) in the case of a product composed in part of hair of the Angora goat and in part of other fibers, words "Shetland" or "Angora", as case may be, may be used; if there are used in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words truthfully describing such other constituent fibers or materials. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, S. Friedman & Sons, etc., Docket 4891, January 8, 1944]

§ 3.6 (c) *Advertising falsely or misleadingly—Composition of goods:* § 3.66 (a 7) *Misbranding or mislabeling—Composition:* § 3.6 (a) *Using misleading name—Goods—Composition.* In connection with offer, etc., in commerce, of knitting yarns, and among other things, as in order set forth, using the unqualified word "crepe", or any other descriptive term indicative of silk, to designate, describe, or refer to any product which is not composed entirely of silk, the product of the cocoon of the silkworm; prohibited: *Provided, however,* That such word or descriptive term may be used truthfully to designate or describe the type of weave, construction, or finish if such word is qualified by using in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words accurately describing the fibers or materials from which such product is made. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, S. Friedman & Sons, etc., Docket 4891, January 8, 1944]

§ 3.71 (a) *Neglecting, unfairly or deceptively, to make material disclosure—Composition.* In connection with offer, etc., in commerce, of knitting yarns, and among other things, as in order set forth, advertising, offering for sale, or selling products composed in whole or in part of rayon without clearly disclosing such rayon content; prohibited: and with the provision that when such products are composed in part of rayon and in part of other fibers or materials, all such fibers or materials, including the rayon, shall be clearly and accurately disclosed. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, S. Friedman & Sons, etc., Docket 4891, January 8, 1941]

§ 3.6 (c) *Advertising falsely or misleadingly—Composition:* § 3.66 (a 7) *Misbranding or mislabeling—Composition:* § 3.94 (a) *Using misleading name—Goods—Composition:* § 3.6 (cc) *Advertising falsely or misleadingly—Source or origin—Place—Foreign in general:* § 3.66 (k) *Misbranding or mislabeling—Source or origin—Place—Foreign and general:* § 3.96 (a) *Using misleading name—Goods—Source or origin—Place—Foreign in general.* In connection with offer, etc., in commerce, of knitting yarns, and among other things, as in order set forth; (1) using the word "Saxony", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool from sheep found only in the Province of Saxony; and (2) using the word "Burma", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool from sheep found only in Burma. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, S. Friedman & Sons, etc., Docket 4891, January 8, 1944]

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C. on the 8th day of January, A. D. 1944.

In the Matter of Abraham Friedman, and Samuel Friedman, Individually and Trading as S. Friedman & Sons, and as Sunray Yarn House

This proceeeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of respondents, a stipulation as to the facts, testimony and other evidence taken before a trial examiner of the Commission theretofore duly designated by it, report of the trial examiner upon the evidence and the exceptions to such report, and briefs in support of and in opposition to the complaint (oral argument not having been requested); and the Commission having made its findings as to the facts and its conclusion that the respondents have violated the provisions of the Federal Trade Commission Act;

It is ordered, That the respondents, Abraham Friedman and Samuel Friedman, individually and trading as S. Friedman & Sons and as Sunray Yarn House, or trading under any other name, and respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering for sale, sale, and distribution of respondents' knitting yarns in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

(1) Using the words "wool", "Tweed", or "worsted", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool: *Provided, however,* That in the case of a product composed in part of wool and in part of other fibers or materials, such words may be used as descriptive of the wool content if there are used in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words truthfully describing such other constituent fibers or materials.

(2) Using the word "Shetland", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool of Shetland sheep grown on the Shetland Islands or the contiguous mainland of Scotland: *Provided, however,* That in the case of a product composed in part of such wool and in part of other fibers or materials, such word may be used as descriptive of the Shetland wool content if there are used in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words truthfully describing such other constituent fibers or materials.

(3) Using the word "Angora", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any products which is not composed entirely of hair of the Angora goat: *Provided, however,* That in the case of a product composed in part of hair of the Angora goat and in part of other fibers or materials such word may be used as descriptive of the Angora fiber content if there are used in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words truthfully describing such other constituent fibers or materials.

(4) Using the unqualified word "crepe", or any other descriptive term indicative of silk, to designate, describe, or refer to any product which is not composed entirely of silk, the product of the cocoon of the silkworm: *Provided, however,* That such word or descriptive term may be used truthfully to designate or describe the type of weave, construction, or finish if such word is qualified by using in immediate connection or conjunction therewith, in letters of at least equal size and conspicuousness, words accurately describing the fibers or materials from which such product is made.

(5) Advertising, offering for sale, or selling products composed in whole or in part of rayon without clearly disclosing such rayon content, and when such products are composed in part of rayon and in part of other fibers or materials, all such fibers or materials, including the rayon, shall be clearly and accurately disclosed.

(6) Using the word "Saxony", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool from sheep found only in the Province of Saxony.

(7) Using the word "Burma", or any simulation thereof, either alone or in connection or conjunction with any other word or words, to designate, describe, or refer to any product which is not composed entirely of wool from sheep found only in Burma.

(8) Misrepresenting in any manner or by any means, directly or by implication, the fibers or materials of which respondents' products are made, or the place or origin of such products.

It is further ordered, That the respondents shall, within sixty (60) days after the service upon them of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with this order.

It is further ordered, That no provision of this order shall be construed as relieving the respondents in any respect of the necessity of complying with the requirements of the Wool Products Labeling Act of 1939 and the rules and regulations promulgated thereunder.

By the Commission.

[SEAL] A. N. ROSS,
Acting Secretary.

[F. R. Doc. 44-1587; Filed, February 1, 1944; 11:27 a. m.]

[Docket No. 4901]

PART 3—DIGEST OF CEASE AND DESIST ORDERS

HOME DIATHERMY CO., INC., ET AL.

§ 3.6 (j 1.7) *Advertising falsely or misleadingly—Government approval, connection or standards—Federal Communications Commission orders:* § 3.6 (y 10) *Advertising falsely or misleadingly—Scientific or other relevant facts.* In connection with the servicing of diathermy machines and the transportation thereof in commerce, and among other things, as in order set forth, representing directly or by implication (1) that it is necessary that diathermy instruments be calibrated in order to comply with Order No. 96 issued by the Federal Communications Commission on May 18, 1942; and (2) that it is impossible to complete the forms required by said Order No. 96 and to register diathermy instruments as provided by said order, unless the instruments are sent to respondents' factory in New York City for calibration; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Home Diathermy Co., Inc., et al., Docket 4901, January 13, 1944]

§ 3.6 (r 4.1) *Advertising falsely or misleadingly—Prices—Government requirements:* § 3.69 (c 3.5) *Misrepresenting oneself and goods—Prices—Government requirements.* In connection with the servicing of diathermy machines and transportation thereof in commerce and among other things, as in order set forth, representing, directly or by implication that it is necessary to pay the sum of $7.50 or any other amount, or to pay delivery charges in any amount to respondents, or any of them, for the calibration of any diathermy instrument in order to comply with said Order No. 96; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Home Diathermy Co., Inc., et al., Docket 4901, January 13, 1944]

§ 3.6 (y 10) *Advertising falsely and misleadingly—Scientific or other relevant facts:* § 3.7 (f 13) *Offering deceptive inducements to purchase or deal—Government penalty.* In connection with the servicing of diathermy machines and the transportation thereof in commerce, and among other things as in order set forth, representing directly or by implication that the owner of a diathermy instrument is subject to a fine in any amount or confiscation of his instrument unless his instrument is calibrated or otherwise serviced by respondents or any other person; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Home Diathermy Co., Inc., et al., Docket 4901, January 13, 1944]

In the Matter of Home Diathermy Company, Inc., a New York Corporation; Home Diathermy Company, Inc., a Pennsylvania Corporation; Arnold Steindler and Isadore Teitelbaum, Individually and as Officers of Home Diathermy Company, Inc., a New York Corporation, and Home Diathermy Company, Inc., a Pennsylvania Corporation

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 13th day of January, A. D. 1944.

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission (no answer having been filed by respondents) and a stipulation as to the facts entered into by and between counsel for the Commission and counsel for the respondents which provides, among other things, that without further evidence or other intervening procedure the Commission may issue and serve upon the respondents herein findings as to the facts and conclusion based thereon and an order disposing of the proceeding, and the Commission having made its findings as to the facts and its conclusion that the respondents have violated the provisions of the Federal Trade Commission Act:

It is ordered, That the respondents, Home Diathermy Company, Inc., a New York corporation, and Home Diathermy Company, Inc., a Pennsylvania corporation, their officers, and Arnold Steindler and Isadore Teitelbaum, individually and as officers of said corporations, and respondents' agents, representatives, and employees, directly or through any corporate or other device, in connection with the servicing of diathermy machines or instruments and the transportation thereof in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from representing, directly or by implication:

1. That it is necessary that diathermy instruments be calibrated in order to comply with Order No. 96 issued by the Federal Communications Commission on May 18, 1942.

2. That it is impossible to complete the forms required by said Order No. 96 and to register diathermy instruments as provided by said order, unless the instruments are sent to respondents' factory in New York City for calibration.

3. That it is necessary to pay the sum of $7.50 or any other amount, or to pay delivery charges in any amount to respondents, or any of them, for the calibration of any diathermy instrument in order to comply with said Order No. 96.

4. That the owner of a diathermy instrument is subject to a fine in any amount or confiscation of his instrument unless his instrument is calibrated or otherwise serviced by respondents or any other person.

It is further ordered, That the respondents shall, within sixty (60) days after service upon them of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with this order.

By the Commission.

[SEAL] A. N. ROSS,
Acting Secretary.

[F. R. Doc. 44-1584; Filed, February 1, 1944; 11:06 a. m.]

[Docket No. 5054]

PART 3—DIGEST OF CEASE AND DESIST ORDERS

KAY LABORATORIES, INC., ET AL.

§ 3.6 (t) *Advertising falsely or misleadingly—Qualities or properties of product:* § 3.6 (x) *Advertising falsely or misleadingly—Results.* In connection with offer, etc., of respondents' "Kaytonik" medicinal preparation or any other similar product, and among other things, as in order set forth, disseminating, etc.,

any advertisements by means of the United States mails, or in commerce, or by any means, to induce, etc., directly or indirectly, purchase in commerce, etc., of respondents' preparation, which advertisements represent, directly or by implication, that (1) said preparation is a preventative or constitutes a competent or effective treatment for colds; (2) the use of said preparation will prevent a cold from developing into grippe, influenza, or pneumonia; and (3) the use of said preparation will build up health, strength, or bodily resistance to disease or conquer or destroy germs; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Kay Laboratories, Inc., et al., Docket 5054, January 21, 1944]

§ 3.6 (n 2) *Advertising falsely or misleadingly—Nature Product;* § 3.96 (a 4) *Using misleading name—Goods—Nature.* In connection with offer, etc., of respondents' "Kaytonik" medicinal preparation or any other similar product, and among other things, as in order set forth, using the word "Kaytonik" as a trade name for the said preparation or otherwise representing that said preparation is a generol tonic or will act as a general tonic to the system; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Kay laboratories, Inc., et al., Docket 5054, January 21, 1944]

§ 3.6 (22) *Advertising falsely or misleadingly—Producer status of dealer or seller—Laboratory:* § 3.69 (a 7.8) *Misrepresenting oneself and goods—Business status—Laboratory status;* § 3.96 (b 5) *Using misleading name—Vendor—Producer or laboratory status of dealer or seller.* In connection with offer, etc., of respondents' "Kaytonik" medicinal preparation or any other similar product, and among other things, as in order set forth, using the word "Laboratories" or any other word of similar import or meaning in respondents' corporate name, or representing through any other means or device, or in any manner, that the respondents own, operate, or control a laboratory equipped for the compounding of medicinal preparations and for research in connection therewith; prohibited. (Sec. 5, 38 Stat. 719, as amended by sec. 3, 52 Stat. 112; 15 U.S.C., sec. 45b) [Cease and desist order, Kay Laboratories, Inc., et al., Docket 5054, January 21, 1944]

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 21st day of January, A. D. 1944.

In the Matter of Kay Laboratories, Inc., a Corporation, and Joseph P. Kayatta, Individually and as President and Treasurer of Kay Laboratories, Inc.

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission and the record, wherein the respondents admitted all the material facts set forth in the complaint and waived all intervening procedure and further hearing as to the facts, and the Commission having made its findings as to the facts and conclusion that said respondents have violated the provisions of the Federal Trade Commission Act:

It is ordered, That the respondents, Kay Laboratories, Inc., a corporation, its officers, directors, representatives, agents and employees, directly or through any corporate or other device, and Joseph P. Kayatta, individually and as an officer of Kay Laboratories, Inc., and his representatives, agents, and employees, in connection with the offering for sale, sale and distribution of their medicinal preparation, Kaytonik, or any other product of substantially similar composition or possessing substantially similar properties, whether sold under the same name or any other name, do forthwith cease and desist from:

1. Disseminating or causing to be disseminated any advertisements by means of United States mails or by any means in commerce as "commerce" is defined in the Federal Trade Commission Act, which advertisement represents, directly or by implication:

a. That said preparation is a preventative or constitutes a competent or effective treatment for colds;

b. That the use of said preparation will prevent a cold from developing into grippe, influenza, or pneumonia;

c. That the use of said preparation will build up health, strength, or bodily resistance to disease or conquer or destroy germs.

2. Disseminating or causing to be disseminated any advertisement by any means for the purpose of inducing, or which is likely to induce, directly or indirectly, the purchase in commerce as "commerce" is defined in the Federal Trade Commission Act, of respondents' preparation, which advertisement contains any of the representations prohibited in paragraph 1 hereof.

3. Using the word "Kaytonik" as a trade name for the said preparation or otherwise representing that said preparation is a general tonic or will act as a general tonic to the system.

4. Using the word "Laboratories" or any other word of similar import or meaning in respondents' corporate name, or representing through any other means or device, or in any manner, that the respondents own, operate, or control a laborat ry equipped for the compounding of medicinal preparations and for research in connection therewith.

It is further ordered, That the respondents and each of them shall within sixty (60) days after service upon them of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with this order.

By the Commission.

[SEAL] OTIS B. JOHNSON,
Secretary.

[F. R. Doc. 44-1585; Filed, February 1, 1944; 11:27 a. m.]

TITLE 21—FOOD AND DRUGS

Chapter I—Food and Drug Administration

PART 155—CANNED OYSTERS; REGULATIONS FOR INSPECTION

MISCELLANEOUS AMENDMENTS

Under the authority of section 702A[1] of the Federal Food, Drug, and Cosmetic Act the following amendments to the regulations for the inspection of canned oysters adopted on December 31, 1943 (9 F.R. 56) are hereby promulgated:

Section 155.30 is hereby amended as follows:

(b) For the year ending June 30, 1944, applications will be considered which are received prior to March 1, 1944.

Section 155.32 is hereby amended to read as follows:

(b) Each initial inspection period shall begin on or after October 1 but not later than Mareh 1 of each year. No initial or extension inspection period shall extend beyond June 30 of any year.

These amendments shall become effective on the date of their publication in the FEDERAL REGISTER.

[SEAL] WATSON B. MILLER,
Acting Administrator.

JANUARY 28, 1944.

[F. R. Doc. 44-1583; Filed, February 1, 1944; 10:57 a. m.]

[1] Section 10A of the Federal Food and Drugs Act (49 Stat. 871; 21 U.S.C. 14a) which remains in force and effect and is applicable to the provisions of the Federal Food, Drug, and Cosmetic Act (52 Stat. 1040 et seq.; 21 U.S.C. 301 et seq.). It is provided in Public Law 135, 78th Congress, Title II, that section 10A of the Federal Food and Drugs Act, as amended by the Act of August 27, 1935 (21 U.S.C. 372a), may hereafter be cited as section 702A of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 301-392).

TITLE 26—INTERNAL REVENUE

Chapter I—Bureau of Internal Revenue

Subchapter A—Income and Excess-Profits Taxes

[Regulations 112]

PART 35—EXCESS PROFITS TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Explanation of regulations—Scope. These regulations are applicable only to taxable years beginning after December 31, 1941, except that where it is appropriate under Regulations 109 to apply with respect to taxable years beginning after December 31, 1939, and before January 1, 1942, the rules applicable to taxable years beginning after December 31, 1941, these regulations shall be applicable. These regulations deal with the excess profits tax imposed by Subchapter E of Chapter 2 of the Internal Revenue Code, which tax is referred to in these regulations as the "excess profits tax." Such tax is to be distinguished from the excess-profits tax imposed by Subchapter B of Chapter 2 of the Internal Revenue Code, referred to in these regulations as the "declared value excess-profits tax," and so designated by section 506 of the Second Revenue Act of 1940, which tax continues in effect and complements the capital stock tax.

Each section, subsection, or paragraph of the Internal Revenue Code set forth in these regulations shall be considered as part of the respective regulations section to which it corresponds.

Arrangement and numbering. Each section of the regulations has been given a key number corresponding to the number of the section or subsection of the Internal Revenue Code which the regulations section interprets. Inasmuch as the regulations constitute Part 35 of Title 26 of the 1943 Supplement to the Code of Federal Regulations, each key number is preceded by the number 35 and a decimal point. The key number is followed by a dash (–) and the identifying number of the regulations section.

Except as otherwise indicated, the statutory references are to the Internal Revenue Code. As used in the regulations, the word "Code" means the Internal Revenue Code.

RATES AND CREDITS

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RATES AND CREDITS [1]

Pertinent Enacting Provisions of the Internal Revenue Code

[Act February 10, 1939, 53 Stat., Part 1]

AN ACT TO CONSOLIDATE AND CODIFY THE INTERNAL REVENUE LAWS OF THE UNITED STATES

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the laws of the United States hereinafter codified and set forth as a part of this act under the heading "Internal Revenue Title" are hereby enacted into law.

SEC. 2. CITATION. This act and the internal Revenue title incorporated herein shall be known as the Internal Revenue Code and may be cited as "I. R. C."

* * * * *

SEC. 6. ARRANGEMENT, CLASSIFICATION, AND CROSS REFERENCES. The arrangement and classification of the several provisions of the Internal Revenue Title have been made for the purpose of a more convenient and orderly arrangement of the same, and, therefore, no inference, implication or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion thereof, nor shall any outline, analysis, cross reference, or descriptive matter relating to the contents of said Title be given any legal effect.

* * * * *

SEC. 710. IMPOSITION OF TAX. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 2, Excess Profits Tax Amendments 1941, by secs. 201 (a) and 202 (e), Rev. Act 1941, and by secs. 202, 203, 204, 205 (a) and (g), 222 (b), and 229 (a), Rev. Act 1942.]

(a) *Imposition*—(1) *General rule.* There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) 90 per centum of the adjusted excess-profits net income, or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter).

(2) [Not applicable to taxable years under these regulations (section 229 (a) (2), Rev. Act 1942).]

(3) [Not applicable to taxable years under these regulations (section 203, Rev. Act 1942).]

(4) *Mutual insurance companies.* In the case of a mutual insurance company other than life or marine, if the gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) is over $75,000 but less than $125,000, the tax imposed under this section shall be an amount which bears the same proportion to the amount ascertained under this section, computed without reference to this paragraph, as the excess over $75,000 of such gross amount received bears to $50,000.

(5) *Deferment of payment in case of abnormality.* If the adjusted excess profits net income (computed without reference to section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, th benefits of section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in section 26 (e) (relating to adjusted excess profits net income), the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the purposes of section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return.

(b) *Definition of adjusted excess profits net income.* As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) *Specific exemption.* A specific exemption of $5,000, and in the case of a mutual insurance company (other than life or marine) which is an interinsurer or reciprocal underwriter a specific exemption of $50,000;

(2) *Excess profits credit.* The amount of the excess profits credit allowed under section 712; and

(3) *Unused excess profits credit.* The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

(c) *Unused excess profits credit adjustment*—(1) *Computation of unused excess profits credit adjustment.* The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits carry-backs to such taxable year.

(2) *Definition of unused excess profits credit.* The term "unused excess profits credit" means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, computed on the basis of the excess profits credit applicable to such taxable year. For such purpose the excess profits credit and the excess profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941. The unused excess profits credit for a taxable year of less than twelve months shall be an amount which is such part of the unused excess profits credit determined under the first sentence of this paragraph as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

(3) *Amount of unused excess profits credit carry-back and carry-over*—(A) *Unused excess profits credit carry-back.* If for any taxable year beginning after December 31, 1941, the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the second preceding taxable year computed for such taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit, and (ii) without the deduction of the specific exemption provided in subsection (b) (1).

(B) *Unused excess profits credit carry-over.* If for any taxable year beginning after December 31, 1939, the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the intervening taxable year computed for such intervening taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit or to any unused excess profits credit carry-back, and (ii) without the deduction of the specific exemption provided in subsection (b) (1). For the purposes of the preceding sentence, the unused excess profits credit for any taxable year beginning after December 31, 1941, shall first be reduced by the sum of the adjusted excess profits net income for each of the two preceding taxable years (computed for each such preceding taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit or to the unused excess profits credit for the succeeding taxable year, and (ii) without the deduction of the specific exemption provided in subsection (b) (1)).

(4) *No carry-back to year prior to 1941.* As used in this subsection, the term "preceding taxable year" and the term "preceding taxable years" do not include any taxable year beginning prior to January 1, 1941.

§ 35.710–1 *Scope of tax.* The excess profits tax is imposed upon the adjusted excess profits net income of every corporation, both domestic and foreign, for each income-tax taxable year beginning after December 31, 1939, except certain corporations which are exempt. (See section 727.) A corporation the excess profits net income of which, computed as provided in section 711 (a) (2) and (3), is not greater than $5,000, or in the case of a mutual insurance company (other than life or marine) which is an interinsurer or reciprocal underwriter is not greater than $50,000, need not file an excess profits tax return. (See section 729 (b).) A personal service corporation, as defined in section 725, may, if it is not a member of an affiliated group of corporations filing consolidated returns under section 141, elect not to be subject to the excess profits tax, thereby making its income taxable to its shareholders as provided in Supplement S of Chapter 1 of the Internal Revenue Code. (See section 725.) The excess profits tax for any year shall not exceed

[1] The sections of law appearing in small type under this heading, other than the enacting provisions, correspond to those under Part I, sections 710–736 of the Internal Revenue Code.

an amount which when added to the normal tax and surtax for such year equals 80 percent of the corporation surtax net income computed without regard to the credit provided in section 26 (e) for income subject to excess profits tax.

§ 35.710–2 *Measure of tax.* The adjusted excess profits net income upon which is based the excess profits tax for a taxable year is determined by deducting from the excess profits net income (determined under the provisions of section 711 applicable to such year) the sum of:

(a) A specific exemption of $5,000, except that in the case of a mutual insurance company (other than life or marine) which is an interinsurer or reciprocal underwriter the specific exemption is $50,000.

(b) The excess profits credit allowed by section 712, and

(c) The unused excess profits credit adjustment (as defined in section 710 (c) (1)) consisting of the aggregate of the unused excess profits credit carry-overs from each of the two preceding excess profits tax taxable years and the excess profits credit carry-backs from each of the two succeeding excess profits tax taxable years, computed as provided in section 710 (c).

For the computation of corporation surtax net income computed without regard to the credit provided in section 26 (e) relating to income subject to the excess profits tax, in those cases where the excess profits tax is an amount which when added to the tax imposed by Chapter 1 (other than section 102) equals 80 percent of such corporation surtax net income, see § 35.710–4.

As to the exemption of income in the case of certain corporations engaged in mining strategic minerals, see section 731; as to the excess profits tax in the case of corporations completing contracts under the Merchant Marine Act of 1936, see section 726; and in the case of corporations deriving abnormal income in the taxable year, see section 721.

For the computation of the excess profits tax for a taxable year of less than 12 months, see the provisions of section 711 (a) (3).

§ 35.710–3 *Unused excess profits credit adjustment*—(a) *Unused excess profits credit.* The unused excess profits credit for any taxable year beginning after December 31, 1939, is the excess of the excess profits credit for the taxable year over the excess profits net income, if any, for such taxable year. In the case of a taxpayer entitled to use the excess profits credit based on income or the excess profits credit based on invested capital, the credit which results in the larger unused excess profits credit is used. The excess profits net income is computed on the basis of the excess profits credit so used. In computing the unused excess profits credit for a taxable year beginning in 1940, the excess profits credit and the excess profits net income for such taxable year shall be computed under the law applicable to taxable years beginning on January 1, 1941.

The unused excess profits credit for a taxable year of less than 12 months is reduced to such part of the unused excess profits credit determined in the manner prescribed in the preceding paragraph as the number of days in the taxable year of less than 12 months is of the number of days in the 12 months ending with the close of the taxable year. In determining the unused excess profits credit which is so reduced, the excess profits net income for the taxable year of less than 12 months is first placed on an annual basis under the provisions of section 711 (a) (3) (A) by reference to the number of days in the taxable year. For example, a taxpayer changes from the calendar year basis to a fiscal year basis ending January 31, and files a return for the taxable year January 1 to January 31, 1942. Its excess profits credit for this taxable year is $91,250. Its excess profits net income computed on the basis of this taxable year is $6,200, and this excess profits net income placed on an annual basis under the provisions of section 711 (a) (3) (A) is $73,000, that is, $\frac{365\times\$6,200}{31}$. The unused excess profits credit computed under the preceding paragraph is, therefore, $18,250, the excess of the $91,250 excess profits credit over the $73,000 excess profits net income placed on an annual basis. The unused excess profits credit for the taxable year January 1 to January 31, 1942, is reduced to $1,550, that is $\frac{31\times\$18,250}{365}$, or such part of $18,250 as the number of days in the taxable year (31) is of the number of days in the 12 months ending with the close of the taxable year (365).

(b) *Unused excess profits credit adjustments.* The unused excess profits credit adjustment is the aggregate of the portions of the unused excess profits credits for the two preceding and two succeeding taxable years which are treated under section 710 (c) (3) as unused excess profits credit carry-overs and unused excess profits credit carry-backs to the taxable year. Under the provisions of section 710 (c) (3) the unused excess profits credit for any taxable year beginning on or after January 1, 1942, is carried back to each of the two preceding taxable years (not considering as a preceding taxable year any taxable year beginning before January 1, 1941) and forms part of the unused excess profits credit adjustment for such preceding taxable year. The unused excess profits credit for any taxable year beginning after December 31, 1939, to the extent it is not used as a carry-back, is carried forward to the two succeeding taxable years and forms part of the unused excess profits credit adjustment for such of those succeeding taxable years as begin after December 31, 1940. The amount which is carried back or carried forward is limited in the case of each such preceding or succeeding taxable year to the portion of the unused excess profits credit which was not applied against excess profits net income (either as part of the excess profits credit carry-over in the case of a taxable year beginning in 1940 or as part of the unused excess profits credit adjustment in the case of a taxable year beginning after December 31, 1940) in determining the adjusted excess profits net income for the taxable years, if any, before such preceding or succeeding taxable year. The amount of the unused excess profits credit which was so applied is determined as follows: The adjusted excess profits net income is computed for each such taxable year without the specific exemption of $5,000 allowed by section 710 (b) (1), and without credit of any carry-over or carry-back from the taxable year in which such unused excess profits credit arose or from any taxable year subsequent thereto. The unused excess profits credit, which is a carry-over or a carry-back to such taxable year, is considered to have been applied against the amount so computed.

The entire unused excess profits credit for any taxable year beginning after December 31, 1939, but not beginning after December 31, 1941, is carried over to the first succeeding taxable year. The unused excess profits credit is carried over the second succeeding taxable year to the extent it exceeds the adjusted excess profits net income for the first succeeding taxable year. For the purpose of determining this excess, the adjusted excess profits net income is computed without credit of the specific exemption of $5,000 allowed by section 710 (b) (1) and without credit of the carry-over from the taxable year in which the unused excess profits credit arose or of any carry-over or carry-back from a taxable year subsequent thereto. The entire unused excess profits credit for any taxable year beginning after December 31, 1941, is carried back to the second preceding taxable year if such taxable year began after December 31, 1940. If the second preceding taxable year began prior to January 1, 1941, the entire unused excess profits credit is carried back to the first preceding taxable year, since a taxable year beginning prior to January 1, 1941, is not considered a "preceding taxable year" for the purposes of section 710 (c) (3), and no part of the adjusted excess profits net income for such a taxable year reduces the amount of the unused excess profits credit for a taxable year beginning after December 31, 1941, which may be carried back or carried over to other taxable years. If the second preceding taxable year began after December 31, 1940, the unused excess profits credit is carried back to the first preceding taxable year to the extent it exceeds the adjusted excess profits net income for the second preceding taxable year, such adjusted excess profits net income being computed without credit of the specific exemption of $5,000 and without credit of any carry-back from the taxable year in which the unused excess profits credit arose. The unused excess profits credit is carried over to the first succeeding taxable year to the extent that it exceeds the aggregate of the adjusted excess profits net incomes for the two preceding taxable years (computed for each such taxable year without credit of the specific exemption of $5,000 and without credit of any carry-back from the taxable year in

which such unused excess profits credit arose or of any carry-back from a taxable year subsequent thereto), not considering as a preceding taxable year any taxable year beginning prior to January 1, 1941. The unused excess profits credit is carried over to the second succeeding taxable year to the extent that the unused excess profits credit exceeds the aggregate of the adjusted excess profits net income for the two preceding taxable years and for the first succeeding taxable year (computed for each such taxable year without credit of the specific exemption of $5,000 and without credit of any carry-over or carry-back from the taxable year in which the unused excess profits credit arose or from any taxable year subsequent thereto), not considering as a preceding taxable year any taxable year beginning prior to January 1, 1941.

The following example illustrates the operation of section 710 (c) (3):

Example. It is assumed that the taxpayer, on the calendar year basis, has an excess profits credit of $100,000. It has no unused excess profits credit for 1940 or 1941. It has $125,000 excess profits net income in 1942, $185,000 excess profits net income in 1943, $55,000 excess profits net income in 1944, $25,000 excess profits net income in 1945, $30,000 excess profits net income in 1946, $160,000 excess profits net income in 1947, and $200,000 excess profits net income in 1948. It has no unused excess profits credit in 1949 or 1950. Since the taxpayer has a $100,000 excess profits credit, and excess profits net income of only $55,000 in 1944, $25,000 in 1945, and $30,000 in 1946, it has an unused excess profits credit of $45,000 in 1944, $75,000 in 1945, and $70,000 in 1946. Such unused excess profits credit will form the basis for carry-backs and carry-overs computed as follows:

(1) The amount of the $45,000 unused excess profits credit for 1944 which may be used as a carry-back to 1942 and 1943 and as a carry-over to 1945 and 1946 is computed as follows:

(i) For 1942, the carry-back is $45,000 (the amount of the unused excess profits credit).

(ii) For 1943, the carry-back is $20,000, determined by deducting from the $45,000 unused excess profits credit the adjusted excess profits net income for 1942 computed without the deduction of the specific exemption or any carry-back from 1944 (the $125,000 excess profits net income for 1942 less the $100,000 excess profits credit for such taxable year, or $25,000).

(iii) For 1945 and 1946 there is no carry-over from 1944 since all of the unused excess profits credit has been applied against the excess profits net income for 1942 and 1943. To determine the carry-over, the $45,000 unused excess profits credit must first be reduced by the sum of the adjusted excess profits net income for 1942 and 1943 computed for each such year without the deduction of any $5,000 specific exemption or of any carry-back from 1944 or from any year subsequent to 1944 (for 1942, the $125,000 excess profits net income less the $100,000 excess profits credit for such year, or $25,000, plus, for 1943, the $185,000 excess profits net income less the $100,000 excess profits credit for such year, or $85,000, a total of $110,000).

(2) The amount of the $75,000 unused excess profits credit for 1945 which may be used as a carry-back to 1943 and 1944, and as a carry-over to 1946 and 1947, is computed as follows:

(i) For 1943, the carry-back is $75,000 (the amount of the unused excess profits credit).

(ii) For 1944, the carry-back is $10,000, determined by deducting from the $75,000 unused excess profits credit the $65,000 adjusted excess profits net income for 1943 computed without the deduction of the $5,000 specific exemption or of any carry-back from 1945 (the $185,000 excess profits net income for 1943, less the $100,000 excess profits credit and the $20,000 excess profits credit carry-back from 1944).

(iii) For 1946, the carry-over is $10,000, determined by reducing the $75,000 unused excess profits credit by the sum of the adjusted excess profits net incomes for 1943 and 1944 computed for each such year without the deduction of any $5,000 specific exemption or of any carry-back from 1945 or any year subsequent to 1945 (for 1943, the $185,000 excess profits net income less the $100,000 excess profits credit and the $20,000 carry-back from 1944, or $65,000, plus, for 1944 the $55,000 excess profits net income less the $100,000 excess profits credit, or $0 adjusted excess profits net income, a total of $65,000).

(iv) For 1947, the carry-over is also $10,000, since there was no adjusted excess profits net income for 1946, computed without the deduction of the $5,000 specific exemption or of any carry-over from 1945 or of any carry-back from any year subsequent to 1945 (the $30,000 excess profits net income for 1946 less the $100,000 excess profits credit), to offset any of the carry-over to such year.

(3) The amount of the $70,000 unused excess profits credit for 1946 which may be taken as a carry-back to 1944 and 1945, and as a carry-over to 1947 and 1948, is computed as follows:

(i) For 1944, the carry-back is $70,000 (the unused excess profits credit).

(ii) For 1945, the carry-back is also $70,000, since there was no adjusted excess profits net income for 1944, computed without the deduction of the $5,000 specific exemption or of the carry-back from 1946 (the excess profits net income of $55,000 for 1944 less the $100,000 excess profits credit and the $10,000 carry-back from 1945) to offset any of such unused excess profits credit for 1946.

(iii) For 1947, the carry-over is also $70,000, since there was no adjusted excess profits net income in 1944 or 1945 to offset any of the unused excess profits credit for 1946. The carry-over to 1947 is computed by reducing the $70,000 unused excess profits credit by the sum of the adjusted excess profits net incomes for 1944 and 1945, computed for each such year without the deduction of any $5,000 specific exemption or of any carry-back from 1946 or from any year subsequent to 1946. (For 1944, the adjusted excess profits net income so computed is $0, that is, the $55,000 excess profits net income for such year less the $100,000 excess profits credit and the $10,000 carry-back from 1945. For 1945, the adjusted excess profits net income so computed is $0, that is, the $25,000 excess profits net income for 1945 less the $100,000 excess profits credit.)

(iv) For 1948, the carry-over is $20,000, computed by reducing the $70,000 carry-over to 1947 by the adjusted excess profits net income for 1947 computed without the deduction of the $5,000 specific exemption or of the carry-over from 1946 or of any carry-back from a year subsequent to 1946 (that is, the $160,000 excess profits net income for 1947 less the $100,000 excess profits credit and the $10,000 carry-over from 1945, or $50,000).

The aggregate of the carry-backs and carry-overs to each taxable year is the unused excess profits credit adjustment for such taxable year which may be credited against excess profits net income to determine adjusted excess profits net income. Therefore, the unused excess profits credit adjustment for 1942 is $45,000, the carry-back to that year from 1944. The unused excess profits credit adjustment for 1943 is $95,000, the aggregate of the $20,000 carry-back from 1944 and the $75,000 carry-back from 1945. The unused excess profits credit adjustment for 1947 is $80,000, the aggregate of the $10,000 carry-over from 1945 and the $70,000 carry-over from 1946. The unused excess profits credit adjustment for 1948 is $20,000, the carry-over from 1946.

In the case of a mutual insurance company (other than life or marine) which is an interinsurer or reciprocal underwriter, the $50,000 exemption allowed in such cases under section 710 (b) (1) is to be substituted wherever reference is made in this section to the $5,000 specific exemption.

(c) *Ascertainment of unused excess profits credit adjustment dependent upon unused excess profits credit carry-back.* If the taxpayer is entitled in computing its unused excess profits credit adjustment to an unused excess profits credit carry-back which it is not able to ascertain at the time its return is due, it shall compute the unused excess profits credit adjustment on its return without regard to such unused excess profits credit carry-back. When the taxpayer ascertains the unused excess profits credit carry-back, it may file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the unused excess profits credit adjustment for the taxable year with the inclusion of such carry-back. Under the provisions of section 3771 (e), as added by section 153 (d) of the Revenue Act of 1942, no interest is allowed with respect to any such overpayment for the period prior to the filing of the claim for credit or refund of such overpayment or prior to the filing of a petition to The Tax Court of the United States asserting such overpayment, whichever is earlier. If the taxpayer files a claim based upon the overpayment caused by a carry-back from the first succeeding taxable year, and later ascertains that it is entitled to a carry-back from the second succeeding taxable year, it shall file a second claim for credit or refund based on the overpayment, if any, caused by the failure to take into account the carry-back from such second succeeding taxable year.

§ 35.710–4 *Rate of tax.* The excess profits tax shall be whichever of the following is the lesser:

(a) An amount equal to 90 per cent of the adjusted excess profits net income, or

(b) An amount which when added to the tax imposed for the taxable year under Chapter 1 (not including the tax under section 102 on account of the improper accumulation of surplus) equals 80 per cent of the corporation surtax net income, computed under section 15 or Supplement G (relating to insurance companies), as the case may be, but without regard to the credit provided in section 26 (e) relating to income subject to excess profits tax.

For the purposes of section 710 (a) (1) (B) and of paragraph (b) of the preceding sentence, the tax imposed for the taxable year under Chapter 1 is the sum of the normal tax and surtax for such year prior to the credit under section 131 for taxes paid to a foreign country or possession of the United States. The corporation surtax net income for such

purposes shall be computed by disregarding the credit under section 26 (e) (relating to income subject to excess profits tax), otherwise provided in section 15 (a) or Supplement G as a reduction against net income, both in determining corporation surtax net income and in determining the amount of net income upon which is computed the 85 per cent limitation upon the credit for dividends received. In all other respects, corporation surtax net income shall be computed as provided in section 15 (a) or Supplement G as the case may be.

The application of section 710 (a) (1) and of this section may be shown by the following example:

Assume that Corporation A, which makes its return on the calendar year basis, is a public utility corporation within the definition in section 26 (h) (2) (A). Its net income for 1942 is $411,000 and includes $100,000 of dividends upon the common stock of a domestic manufacturing company, $10,000 of dividends upon the preferred stock (as defined in section 26 (h) (2) (B)) of a public utility corporation which it owns, and $1,000 of interest on certain United States Government obligations which is exempt from the normal tax. It has paid a dividend of $5,000 on its preferred stock (as defined in section 26 (h) (2) (B)). Its excess profits net income is $500,000, its excess profits credit is $145,000, and it has no unused excess profits credit adjustment. Its excess profits tax is $254,955, computed as follows:

Excess profits tax		
1. Excess profits net income		$500,000
2. Specific exemption	$5,000	
3. Excess profits credit	145,000	
4. Total of item 2 and item 3		150,000
5. Adjusted excess profits net income		350,000
6. Excess profits tax (90 percent of item 5)		315,000
7. Net income (computed without regard to credit provided in section 26 (e) relating to income subject to excess profits tax)		411,000
8. (*a*) Total dividends received	$110,000	
(*b*) Less dividends received on preferred stock of a public utility corporation	10,000	
(*c*) Difference	100,000	
9. Less:		
(*a*) Dividends received credit (85 percent of item 8 (*c*) but not in excess of 85 percent of item 7)	85,000	
(*b*) Dividends paid on certain preferred stock	5,000	
		90,000
10. Corporation surtax net income (computed without regard to the credit provided in section 26 (e)) (item 7 minus item 9)		321,000
11. 80 percent of item 10		256,800
12. Income tax under Chapter 1 (other than section 102) for the taxable year (item 31)		1,845
13. Excess of item 11 over item 12		254,955
14. Excess profits tax (item 6 or item 13, whichever is lesser)		254,955
Normal tax		
15. Net income		$411,000
16. Less: Credit under section 26 (a) for interest on certain United States obligations		1,000
17. Adjusted net income		410,000
18. Less income subject to excess profits tax (credit under section 26 (e)) (item 5)		350,000
19. Item 17 minus item 18		60,000
20. Total dividends received	$110,000	
21. Dividends received credit (85 percent of item 20 but not in excess of 85 percent of item 19)		51,000
22. Normal tax net income		9,000
23. Normal tax ($750 plus 17 percent of $4,000)		1,430
Surtax		
24. Net income		$411,000
25. Less income subject to excess profits tax (credit under section 26 (e)) (item 5)		350,000
26. Item 24 minus item 25		61,000
27. (*a*) Total dividends received	$110,000	
(*b*) Less dividends received on preferred stock of public utility corporation	10,000	
(*c*) Difference	100,000	
28. Less: (*a*) Dividends received credit (85 percent of item 27 (c) but not in excess of 85 percent of item 26)	51,850	
(*b*) Dividends paid on certain preferred stock	5,000	
		56,850
29. Corporation surtax net income		4,150
30. Surtax (10 percent of item 29)		415
31. Total normal tax and surtax (item 23 plus item 30)		1,845

If a mutual insurance company, other than life or marine, receives a gross amount from interest, dividends, rents, and premiums (including deposits and assessments) in excess of $75,000 but less than $125,000, the tax imposed under section 710 is an amount which bears the same proportion to the amount of tax otherwise determined under such section, computed without regard to section 710 (a) (4) and the provisions of this sentence, as the excess over $75,000 of such gross amount received bears to $50,000. For example, assume that a mutual insurance company (other than a life or marine insurance company) receives a gross amount from interest, dividends, rents, and premiums of $115,000, and that its excess profits tax computed under section 710 (a) (1) is $18,000. Under section 710 (a) (4), the excess profits tax imposed under section 710 is $14,400, that is, $\frac{40{,}000 \times \$18{,}000}{50{,}000}$.

§ 35.710–5 *Deferment of payment of tax in case of base period or invested capital abnormality.* If a taxpayer claims the benefits of section 722 (relating to general excess profits tax relief through a constructive average base period net income), it must make its return and compute and pay its tax without the benefits of such section, and not later than six months after the date prescribed by law for the filing of its return make application for relief under such section. (See section 722 (d).) However, if the adjusted excess profits net income so computed on its return (without the benefits of section 722) for such year exceeds 50 percent of the taxpayer's normal tax net income for such year, computed without the credit provided in section 26 (e) for income subject to excess profits tax, and if the taxpayer on its return claims to be entitled to the benefits of section 722, the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 percent of the reduction in tax so claimed. (See section 710 (a) (5).) In computing the normal tax net income for purposes of the 50 percent determination, the credit for dividends received under section 26 (b) shall be limited to 85 percent of adjusted net income unreduced by the credit under section 26 (e) for income subject to excess profits tax.

The amount of reduction in tax claimed under section 722 shall be the difference between the amount of tax computed under section 710 (a) (1) without the benefit of section 722 (prior to the credit under section 729 for taxes paid to a foreign country or to a possession of the United States, to the credit under section 783 for debt retirement, and to the adjustment under section 734 on account of an inconsistent position) and the amount of tax so computed by using instead of the actual excess profits credit the excess profits credit based upon the constructive average base period net income claimed by the taxpayer. In any case in which the excess profits tax computed with the use of the constructive average base period net income is determined under section 710 (a) (1) (B) as an amount which when added to the normal

tax and surtax imposed under Chapter 1 equals 80 percent of the corporation surtax net income (computed without regard to the credit under section 26 (e) for income subject to excess profits tax), the credit for income subject to excess profits tax provided in section 26 (e), and used in determining normal tax net income and corporation surtax net income shall be computed for the purposes of determining such normal tax and surtax by using the excess profits credit based upon the constructive average base period net income in lieu of the actual excess profits credit.

A taxpayer which claims to be entitled to a tax deferment under the provisions of section 710 (a) (5) and of this section must, at the time of filing its excess profits tax return on Form 1121, attach thereto an application for relief under section 722 on Form 991 (revised January, 1943). The application must set forth under oath each ground under section 722 upon which the application for relief is based and facts sufficient to apprise the Commissioner of the exact basis thereof and to establish eligibility for relief, as well as data and information in sufficient detail to establish the amount of constructive average base period net income claimed, the amount of tax reduction claimed by the use of section 722, and the amount of tax deferment claimed on the return. In any case in which an application for relief on Form 991 (revised January, 1943) is not so attached to the excess profits tax return, the taxpayers shall not be deemed to have claimed on its return the benefits of section 722. In such case the amount of tax deferment claimed under section 710 (a) (5) and this section shall be added to the amount of tax otherwise shown by the taxpayer to be payable. For the purposes of section 271 (made applicable to Subchapter E of Chapter 2 by section 729) relating to the definition of deficiency, the amount of tax shown by the taxpayer to be payable so increased shall be considered the amount of tax shown on the return.

For the purposes of section 271, in case a taxpayer has claimed a tax reduction under section 710 (a) (5) and has attached Form 991 (revised January, 1943) to its excess profits tax return as provided in this section, the tax so reduced shall be the tax shown on the return.

If a constructive average base period net income has been finally determined and has been used in computation of the excess profits tax for a prior excess profits tax taxable year under section 722 and under regulations prescribed under such section, such constructive average base period net income may be applicable in the computation of the excess profits tax for the current excess profits tax taxable year. In such case, the excess profits tax for such current year shall be computed with the use of such constructive average base period net income, and the provisions of section 710 (a) (5) shall be inapplicable with respect to such year.

The application of section 710 (a) (5) may be illustrated by the following example:

Assume that Corporation B, which makes its return on the calendar year basis, has for 1942 a net income of $1,010,000, which includes $300,000 of dividends on the common stock of domestic manufacturing corporations, $10,000 of interest on certain United States Government obligations which is exempt from the normal tax, and $200,000 of long-term capital losses which are offset against an equal amount of short-term capital gains. Its adjusted net income is $1,000,000, and it has an excess profits credit of $95,000, and no unused excess profits credit adjustment. It has filed, with its excess profits tax return for 1942, an application for relief under section 722 in which it claims a constructive average base period net income of $600,000. Its excess profits tax return for 1942, computed without regard to section 722, shows an amount of tax deferred under section 710 (a) (5) of $99,584.10, and an excess profits tax due of $494,685.90, computed as follows:

	Excess profits tax	
1.	Normal tax net income (computed without allowance of credit under section 26 (e) for income subject to excess profits tax and without allowance of dividends received credit) (item 22)	$1,000,000.00
2.	Plus long-term capital loss adjustment	200,000.00
3.	Item 1 plus item 2	1,200,000.00
4.	Less dividend received credit adjustment (100 percent of item 25)	300,000.00
5.	Excess profits net income	900,000.00
6.	Less specific exemption	$5,000.00
7.	Excess profits credit	95,000.00
8.	Total of item 6 and item 7	100,000.00
9.	Adjusted excess profits net income (item 5 minus item 8)	800,000.00
10.	Excess profits tax (90 percent of item 9)	720,000.00
11.	Net income (computed without regard to credit provided in section 26 (e) relating to income subject to excess profits tax) (item 21)	1,010,000.00
12.	Dividends received	$300,000.00
13.	Less dividends received credit (85 percent of item 12, but not in excess of 85 percent of item 11)	255,000.00
14.	Corporation surtax net income (computed without regard to the credit provided in section 26 (e)) (item 11 minus item 13)	755,000.00
15.	80 percent of item 14	604,000.00
16.	Income tax under Chapter 1 (other than section 102) for the taxable year (item 36)	9,730.00
17.	Excess of item 15 over item 16	594,270.00
18.	Excess profits tax (item 10 or item 17, whichever is lesser)	594,270.00
19.	Less tax deferred under section 710 (a) (5) (item 56)	99,584.10
20.	Excess profits tax payable (item 18 minus item 19)	494,685.90
	Normal tax	
21.	Net income	$1,010,000.00
22.	Adjusted net income (item 21 minus $10,000 interest on certain United States obligations)	1,000,000.00
23.	Less income subject to excess profits tax (credit under section 26 (e)) (item 9)	800,000.00
24.	Item 22 minus item 23	200,000.00
25.	Dividends received	$300,000.00
26.	Less dividends received credit (85 percent of item 25 but not in excess of 85 percent of item 24)	170,000.00
27.	Normal tax net income	30,000.00
28.	Normal tax ($4,250 plus 31 percent of $5,000)	5,800.00
	Surtax	
29.	Net income (item 21)	$1,010,000.00
30.	Less income subject to excess profits tax (credit under section 26 (e)) (item 9)	800,000.00
31.	Item 29 minus item 30	210,000.00
32.	Dividends received	$300,000.00
33.	Less dividends received credit (85 percent of item 32 but not in excess of 85 percent of item 31)	178,500.00
34.	Corporation surtax net income	31,500.00
35.	Surtax ($2,500 plus 22 percent of $6,500)	3,930.00
36.	Total normal tax and surtax (item 28 plus item 35)	9,730.00

Percentage which adjusted excess profits net income bears to normal tax net income computed without credit under section 26 (e) for income subject to excess profits tax

37. Adjusted excess profits net income computed without regard to section 722 (item 9)		$800,000.00
38. Adjusted net income (item 22)		1,000,000.00
39. Dividends received	$300,000	
40. Dividends received credit (85 percent of item 39 but not in excess of 85 percent of item 38)		255,000.00
41. Normal tax net income (computed without regard to the credit for income subject to excess profits tax under section 26 (e))		745,000.00
42. Percentage which item 37 bears to item 41 ---percent--		107

Tax deferred under section 710 (a) (5)

EXCESS PROFITS TAX UNDER SECTION 722

43. Excess profits net income (item 5)		$900,000.00
44. Less specific exemption	$5,000.00	
45. Excess profits credit based on constructive excess profits net income under section 722 (95 percent of $600,000)	570,000.00	
46. Item 44 plus item 45		575,000.00
47. Adjusted excess profits net income computed under section 722 (item 43 minus item 46)		325,000.00
48. Excess profits tax under section 722 (90 percent of item 47)		292,500.00
49. Corporation surtax net income (computed without regard to the credit provided in section 26 (e)) (item 14)		755,000.00
50. 80 percent of item 49		604,000.00
51. Income tax under Chapter 1 (other than section 102) for the taxable year, computed with the excess profits tax determined under section 722 (item 72)		169,600.00
52. Excess of item 50 over item 51		434,400.00
53. Excess profits tax computed without the benefit of section 722 (item 17)		594,270.00
54. Excess profits tax computed under section 722 (item 48 or item 52, whichever is lesser)		292,500.00
55. Amount of tax reduction claimed under section 722 (item 53 minus item 54)		301,770.00
56. Amount of tax deferred under section 710 (a) (5) (33 percent of item 55)		99,584.10

Normal tax

57. Net income (item 21)		$1,010,000.00
58. Adjusted net income (item 22)		1,000,000.00
59. Less income subject under section 722 to excess profits tax (credit under section 26 (e)) (item 47)		325,000.00
60. Item 58 minus item 59		675,000.00
61. Dividends received	$300,000.00	
62. Less dividends received credit (85 percent of item 61 but not in excess of 85 percent of item 60)		255,000.00
63. Normal-tax net income		420,000.00
64. Normal tax (24 percent of item 63)		100,800.00

Surtax

65. Net income (item 21)		$1,010,000.00
66. Less income subject under section 722 to excess profits tax (credit under section 26 (e)) (item 47)		325,000.00
67. Item 65 minus item 66		685,000.00
68. Dividends received	$300,000.00	
69. Less dividends received credit (85 percent of item 68 but not in excess of 85 percent of item 67)		255,000.00
70. Corporation surtax net income (item 67 minus item 69)		430,000.00
71. Surtax (16 percent of item 70)		68,800.00
72. Total normal tax and surtax (item 64 plus item 71)		169,600.00

SEC. 711. EXCESS PROFITS NET INCOME. [Added by sec. 201, Second Rev. Act 1940; amended by secs. 3 and 12 (b), Excess Profits Tax Amendments 1941, by sec. 202 (c) and (d), Rev. Act 1941, and by secs. 205 (b) and (c), 206, 207, 208, 209 (a) and (b), 210, 211, and 213, Rev. Act 1942.]

(a) *Taxable years beginning after December 31, 1939.* The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax income, as defined in section 18 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.* If the excess profits credit is computed under section 713, the adjustments shall be as follows:

(A) *Income subject to excess profits tax.* In computing such normal-tax net income the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

(B) *Gains and losses from sales or exchanges of capital assets.* There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

(C) *Income from retirement or discharge of bonds, and so forth.* There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

(D) *Refunds and interest on Agricultural Adjustment Act taxes.* There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;

(E) *Recoveries of bad debts.* There shall be excluded income attributable to the recovery of a bad debt if a deduction with reference to such debt was allowable from gross income for any taxable year beginning prior to January 1, 1940;

(F) *Dividends received.* The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations.

(G) [Not applicable to taxable years under these regulations (section 206 (b) (1), Rev. Act 1942).]

(H) *Life insurance companies.* In the case of a life insurance company, there shall be deducted from the normal tax net income, the excess of (i) the product of (I) the figure determined and proclaimed under section 202 (b) and (II) the excess profits net income computed without regard to this subparagraph, over (2) the adjustment for certain reserves provided in section 202 (c).

(I) *Nontaxable income of certain industries with depletable resources.* In the case of a producer of minerals, or a producer of logs or lumber from a timber block, as defined in section 735, there shall be excluded nontaxable income from exempt excess output of mines and timber blocks and nontaxable bonus income provided in section 735.

(J) *Net operating loss deduction adjustment.* The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations specified in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (B), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(2) *Excess profits credit computed under invested capital credit.* If the excess profits

credit is computed under section 714, the adjustments shall be as follows:

(A) *Dividends received.* The credit for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except that no credit for dividends received shall be allowed with respect to dividends (actual or constructive) on stock of foreign personal holding companies or dividends on stock which is not a capital asset.

(B) *Interest.* The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a));

(C) *Income subject to excess-profits tax.* In computing such normal-tax net income the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

(D) *Gains and losses from sales or exchanges of capital assets.* There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

(E) *Income from retirement or discharge of bonds, and so forth.* There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

(F) *Refunds and interest on Agricultural Adjustment Act taxes.* There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;

(G) *Interest on certain government obligations.* The normal-tax net income shall be increased by an amount equal to the amount of the interest on obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income, if the taxpayer has so elected under section 720 (d); and

(H) *Recoveries of bad debts.* There shall be excluded income attributable to the recovery of a bad debt if a deduction with reference to such debt was allowable from gross income for any taxable year beginning prior to January 1, 1940.

(I) [Not applicable to taxable years under these regulations (section 206 (b) (2), Rev. Act 1942).]

(J) In the case of a life insurance company, there shall be deducted from the normal tax net income, 50 per centum of the excess of (1) the product of (i) the figure determined and proclaimed under section 202 (b) and (ii) the excess profits net income computed without regard to this subparagraph, over (2) the adjustment for certain reserves provided in section 202 (c).

(K) *Nontaxable income of certain industries with depletable resources.* In the case of a producer of minerals, or a producer of logs or lumber from a timber block, as defined in section 735, there shall be excluded nontaxable income from exempt excess output of mines and timber blocks and nontaxable bonus income provided in section 735.

(L) *Net operating loss deduction adjustment.* The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714 the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations provided in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (D), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(3) *Taxable year less than twelve months—* (A) *General rule.* If the taxable year is a period of less than twelve months the excess profits net income for such taxable year (referred to in this paragraph as the "short taxable year") shall be placed on an annual basis by multiplying the amount thereof by the number of days in the twelve months ending with the close of the short taxable year and dividing by the number of days in the short taxable year. The tax shall be such part of the tax computed on such annual basis as the number of days in the short taxable year is of the number of days in the twelve months ending with the close of the short taxable year.

(B) *Exception.* If the taxpayer establishes its adjusted excess profits net income for the period of twelve months beginning with the first day of the short taxable year, computed as if such twelve-month period were a taxable year, under the law applicable to the short taxable year, and using the credits applicable in determining the adjusted excess profits net income for such short taxable year, then the tax for the short taxable year shall be reduced to an amount which is such part of the tax computed on such adjusted excess profits net income so established as the excess profits net income for the short taxable year is of the excess profits net income for such twelve-month period. The taxpayer (other than a taxpayer to which the next sentence applies) shall compute the tax and file its return without the application of this subparagraph. If, prior to one year from the date of the beginning of the short taxable year, the taxpayer has disposed of substantially all its assets, in lieu of the twelve-month period provided in the preceding provisions of this subparagraph, the twelve-month period ending with the close of the short taxable year shall be used. For the purposes of this subparagraph, the excess profits net income for the short taxable year shall not be placed on an annual basis as provided in subparagraph (A), and the excess profits net income for the twelve-month period used shall in no case be considered less than the excess profits net income for the short taxable year. The benefits of this subparagraph shall not be allowed unless the taxpayer, at such time as regulations prescribed hereunder require, makes application therefor in accordance with such regulations, and such application, in case the return was filed without regard to this subparagraph, shall be considered a claim for credit or refund. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary for the application of this subparagraph.

§ 35.711 (a)–1 *Excess profits net income for the taxable year.* Two methods are provided for determining the excess profits net income for the taxable year. One method, that provided by section 711 (a) (1), is to be used if the excess profits credit is computed under section 713, which credit is referred to in these regulations as the income credit. The other method, that provided by section 711 (a) (2), is to be used if the excess profits credit is computed under section 714, which credit is referred to in these regulations as the invested capital credit. As to corporations entitled to use the excess profits credit based on income or the excess profits credit based on invested capital, whichever credit results in the lesser excess profits tax, and corporations required to use the excess profits credit based on invested capital, see section 712. Under either method, the excess profits net income is computed in the same manner as the normal-tax net income but with adjustments in certain items of income, deductions, and credits which otherwise would be used in computing normal-tax net income as defined in section 13 (a) (2). Adjustments in items of income, deductions, and credits are to be made as provided in section 711 (a) (1) or section 711 (a) (2), whichever is applicable. Adjustments are also to be made in deductions which, in computing normal-tax net income, are limited by other items of deductions, or by items of income (for example, the deduction for capital losses under section 117 (d) (1)), or by net income (for example, the deduction for corporate charitable contributions under section 23 (q)), or by the net income from property (for example, the deduction for discovery or percentage depletion under section 114 (b) (2), (3), and (4)), the limitation upon such deductions being determined for purposes of computing excess profits net income with reference to such items of income, or deductions, or net income, or the net income from property as adjusted under section 711 (a) (1) or section 711 (a) (2), whichever is applicable. If normal-tax net income is first determined (except for the credit for adjusted excess profits net income provided in section 26 (e)), for convenience in computing excess profits net income, where the limitations described in this paragraph are not involved, the adjustments may be made by additions and subtractions from the amount of such normal-tax net income, instead of by completely recomputing normal-tax net income.

§ 35.711 (a)–2 *Excess profits net income if income credit is used.* If the excess profits credit for the taxable year is computed under section 713, the excess profits net income for such year is the normal-tax net income as recomputed after making the adjustments provided in section 711 (a) (1).

For the purpose of making the adjustment under section 711 (a) (1) (B) for certain capital gains and losses, gains and losses from sales or exchanges of capital assets are determined under the definitions and in the manner provided under Chapter 1. In recomputing normal-tax net income for the purpose of determining excess profits net income for the taxable year, capital gains and losses from the sale or exchange of capital assets held for more than six months are to be excluded and the excess of losses from sales or exchanges of capital assets held for not more than six months over gains from the sale or exchange of capital assets held for not more than six months is also to be excluded. For example, a corporation has $4,000 in gains from sales of capital assets held

for more than six months, $3,000 in gains from sales of capital assets held not more than six months, and $6,000 in losses from sales of capital assets held not more than six months. The $4,000 long-term capital gains are to be excluded for excess profits tax purposes. Accordingly, the deduction for short-term capital losses for excess profits tax purposes is limited to $3,000, the amount of the short-term capital gains. Since capital losses are allowed as a deduction only to the extent of capital gains (section 117 (d) (1)), and since both long-term gains and losses are excluded for excess profits tax purposes, short-term losses are allowed only to the extent of the remaining short-term gains.

In making the adjustment provided in section 711 (a) (1) (C), the term "indebtedness" as used therein includes indebtedness assumed by the taxpayer even though such indebtedness is evidenced, so far as the taxpayer is concerned, only by a contract (which has been outstanding for more than six months) with the person whose liabilities have been assumed. Also, a renewal obligation is to be considered to be outstanding for more than six months if the original obligations and the renewal obligations taken together have been outstanding for a total of more than six months. The term "other evidence of indebtedness" does not include open account book entries.

The refunds of Agricultural Adjustment Act taxes referred to in section 711 (a) (1) (D) include only those made under Title VII of the Revenue Act of 1936 and refunds made to processors under section 15 (a) of the Agricultural Adjustment Act as reenacted by section 601 of the Revenue Act of 1936.

The provisions of section 711 (a) (1) (E), relating to recoveries of bad debts, are not applicable in the case of a taxpayer using the reserve method of treating bad debts as provided in §§ 29.23 (k)–1 and 29.23 (k)–5 of this chapter.

Deductions which are limited by items of income or deductions, or by the net income or the net income from property are to be computed upon the basis of such items or such net income or net income from property as adjusted under section 711 (a) (1) in recomputing normal-tax net income for the purpose of determining the amount of excess profits net income.

Section 711 (a) (1) (J) provides for recomputation of the net operating loss deduction in computing excess profits net income under the income credit. The various steps in computing the deduction are to be taken in the same manner and for the same years as are provided in section 122 and in the regulations thereunder, except as prescribed in the rules set forth in section 711 (a) (1) (J). The exceptions prescribed by section 711 (a) (1) (J) require that in the computation of the net operating loss for any taxable year under section 122 (a) and in the computation of the net income for any taxable year under section 122 (b) no deduction shall be allowed for any excess profits tax and, if the excess profits credit was computed under the invested capital method for the taxable year in which the loss was sustained or the net income arose, the deduction for interest for such taxable year shall be reduced by amount of any reduction for such taxable year prescribed under section 711 (a) (2) (B). Furthermore, in lieu of the reduction prescribed in section 122 (c) for converting the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction, the reduction for such purpose shall be the amount by which the excess profits net income for the taxable year in which the deduction is allowable, computed with the exceptions and limitations specified in section 122 (d) (1), (2), (3), and (4) and computed without regard to section 711 (a) (1) (B) (excluding long-term capital gains and losses), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26 (a) exceeds the excess profits net income for such taxable year (computed without any net operating loss deduction). The net operating loss deduction so computed with the adjustments prescribed by section 711 (a) (1) (J) is deducted in computing normal-tax net income to determine excess profits net income, in lieu of the net operating loss deduction otherwise prescribed in sections 23 (s) and 122.

The computation of net operating loss, net operating loss carry-back and carry-over, and the net operating loss deduction for purposes of excess profits net income is illustrated by the following example:

Example. The X Corporation makes its income tax returns on a calendar year basis and under the accrual method of accounting. Its only net operating loss for the years 1939–1946, inclusive, occurs in 1944. Under section 122 (b), the net operating loss for 1944 first is to be carried back to 1942 and the balance of such carry-back, if any, computed as provided in sections 122 (b) and 711 (a) (1) (J) (i) is to be carried back to 1943. For 1942, 1943, and 1944, the facts with respect to the X Corporation as are follows:

	1942	1943	1944
(a) Tax exempt interest from State bonds	$1,000	$1,000	$1,000
(b) Dividends received	10,000	10,000	10,000
(c) Long-term capital gain	2,500	3,000	
(d) Interest from United States obligations	2,000	2,000	2,000
(e) Other items of gross income	200,000	300,000	20,000
(f) Total taxable gross income (sum of items (b), (c), (d), and (e))	214,500	315,000	32,000
(g) Deductions (other than net operating loss deduction; no capital losses)	154,500	177,000	115,000
(h) Net income or (loss)	60,000	138,000	(83,000)
(i) Credit for interest from United States obligations	2,000	2,000	2,000
(j) Adjusted net income	58,000	136,000	(85,000)
(k) Credit for dividends received (85 percent of amount in item (b) but not more than 85 percent of adjusted net income)	8,500	8,500	
(l) Normal-tax net income (computed without net operating loss deduction and without credit for income subject to excess profits tax)	49,500	127,500	(85,000)

In order to determine the net operating loss for 1944 there must be added to the total gross taxable income of $32,000, the $1,000 of tax exempt interest, as provided in section 122 (d) (2). Accordingly the net operating loss for 1944 is $82,000, the excess of $115,000 (item (*g*)) over $83,000 (the sum of item (*f*), $32,000, and item (*a*), $1,000). The net operating loss deduction for 1942 is the amount of this carryback, reduced as provided in section 711 (a) (1) (J) (ii). This reduction is the excess of the amount of excess profits net income for 1942 with certain adjustments provided in section 711 (a) (1) (J) (ii) over the amount of excess profits net income for 1942 (computed without the net operating loss deduction). The amount of excess profits net income for 1942 computed without the net operating loss deduction is $45,500, computed as follows:

Normal-tax net income for 1942, as previously determined		$49,500
Less:		
Long-term capital gain	$2,500	
Credit for balance of dividends received	1,500	
		4,000
Excess profits net income (computed without net operating loss deduction)		45,500

The amount of excess profits net income computed with the adjustment provided in section 711 (a) (1) (J) (ii) from which the $45,500 is to be deducted is $61,000, computed as follows:

Excess profits net income (computed without net operating loss deduction in accordance with section 122 (d) (3)		$45,500
Plus:		
Tax exempt interest	1,000	
Long-term capital gain	2,500	
Amount of credit for dividends received	10,000	
Amount of credit for interest received	2,000	
Total		61,000

Since $61,000 exceeds $45,500 by $15,500, the net operating loss carry-back of $82,000 to 1942 is to be reduced by $15,500, leaving a net operating loss deduction of $66,500 for the purpose of determining excess profits net income for 1942.

In this example, the net operating loss carry-back from 1944 to 1943 is the excess of the carry-back, $82,000, over the net income for 1942 computed under sections 122 (b) (1) and 711 (a) (1) (J) (i) as follows:

Net income for 1942, as previously determined		$60,000
Plus:		
Tax exempt interest	1,000	
Total		61,000

It will be noted that the excess profits tax for 1942 is not allowed under section 711 (a) (1) (J) (i) as a deduction in computing the above amount ($61,000) although it is allowed for income tax purposes as a deduction in computing net operating loss, as provided in section 122 (d) (6). The net operating loss carry-back to 1943 for purposes of excess profits tax therefore is $21,000 (the excess of $82,000 over $61,000). The net operating loss deduction for 1943 for purposes of excess profits net income for 1943 is the

amount of $21,000 reduced as provided in section 711 (a) (1) (J) (ii). The amount of this reduction is computed in the same manner as the corresponding reduction was previously computed for 1942. That is, the excess profits net income for 1943, computed without net operating loss deduction, is $123,000, computed as follows:

Normal-tax net income, as previously determined		$127,500
Less:		
Long-term capital gain	$3,000	
Credit for balance of dividends received	1,500	
		4,500
Excess profits net income (computed without net operating loss deduction)		123,000

The amount which is in excess of this amount of $123,000 is $139,000, computed with the adjustments provided in section 711 (a) (1) (J) (ii) as follows:

Excess profits net income (computed without net operating loss deduction in accordance with section 122 (d) (3))		$123,000
Plus:		
Tax-exempt interest	1,000	
Long-term capital gain	3,000	
Amount of credit for dividends received	10,000	
Amount of credit for interest received	2,000	
Total		139,000

The excess of $139,000 over $123,000 is $16,000. Since the net operating loss carry-back to 1943 ($21,000) must be reduced by this amount $16,000) in determining the deduction for 1943, the net operating loss deduction allowable for the purpose of determining excess profits net income for 1943 is $5,000.

In this example, no net operating loss carry-over from 1944 is allowable to 1945 or 1946. The net operating loss for 1944, $82,000, does not exceed the sum of the net income for 1942 and 1943 when the net income for 1942 and 1943 is computed under section 122 (b) (2) and section 711 (a) (1) (J) (ii). The net income for 1942 as previously determined under such sections is $61,000. The net income for 1943 computed under such sections is $139,000 computed as follows:

Net income for 1943 as previously determined		$138,000
Plus:		
Tax exempt interest	1,000	
Total		139,000

For a deduction from normal-tax net income in the case of life insurance companies for the purpose of determining excess profits net income, see section 711 (a) (1) (H). For exclusion of nontaxable income from exempt excess output of mines and timber blocks and nontaxable bonus income provided in section 735 in the case of a producer of minerals, or a producer of logs or lumber from a timber block, as defined in section 735, see section 711 (a) (1) (I).

The computation of the excess profits net income in cases where the income credit is used may be illustrated by the following example:

Example. The facts with respect to the X Corporation for the calendar year 1942 are as follows:

(1) The normal-tax net income of the corporation, computed without regard to the credit provided in section 26 (e) for income subject to the excess profits tax, is $400,000.

(2) The corporation has gains of $100,000 and losses of $75,000 from sales and exchanges of capital assets held for more than six months. It has no gains or losses from sales or exchanges of capital assets held for not more than six months.

(3) On January 1, 1932, the corporation issued at a premium of $40,000 bonds with a total face value of $800,000, maturing December 31, 1951. On January 1, 1942, the corporation purchases one-half of the amount of the bonds for $390,000. For the years 1932 to 1941, inclusive, it had returned $10,000 as income with respect to the premium on the bonds it so purchased. The corporation did not comply with the provisions of section 22 (b) (9) for excluding from gross income the income from the retirement of its bonds.

(4) The corporation derives income in the amount of $400 attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon such refund.

(5) For the calendar year 1935, the corporation deducted $10,000 as a bad debt. The deduction of all bad debts for the calendar year 1935 resulted in a reduction of its tax for that year. During the calendar year 1942, it recovers $5,000 with respect to such debt.

(6) The corporation receives as dividends: $100,000 of the class with respect to which a credit is allowed by section 26 (b), $20,000 from a China Trade Act corporation, and $20,000 from a foreign corporation which is not a foreign personal holding company.

If the income credit is used, the excess profits net income of the corporation for the calendar year 1942 is $314,600, computed as follows:

Normal-tax net income (computed without regard to the credit provided by section 26 (e) for income subject to the excess profits tax)		$400,000
Plus:		
Losses from the sale or exchange of capital assets held for more than six months		75,000
		475,000
Less:		
Gains from the sale or exchange of capital assets held for more than six months	$100,000	
Income from retirement of bonds	20,000	
Income from refunds of Agricultural Adjustment Act taxes and interest thereon	400	
Income from recovery of bad debts	5,000	
Additional dividends received credit (100 per cent of total dividends of $120,000 received from domestic corporations including the China Trade Act Corporations, less credit of $85,000 already allowed by section 26 (b) for dividends received, or $120,000 minus $85,000	35,000	
		160,400
Excess profits net income		314,600

It is to be observed that no adjustment under section 711 (a) (1) (F) is required to be made for the $20,000 dividends received from the foreign corporation.

§ 35.711 (a)–3 *Excess profits net income if invested capital credit is used.* If the excess profits credit for the taxable year is computed under section 714, then the excess profits net income for such year is the normal-tax net income recomputed with the adjustments provided in section 711 (a) (2). Under section 711 (a) (2) (A), there must be eliminated in computing normal-tax net income the credit allowed under Chapter 1 for dividends received on stock which is not a capital asset as defined in section 117, such as stock held primarily for sale to customers by a dealer in securities. Otherwise the adjustments are the same as the adjustments provided in section 711 (a) (1) except that the following additional adjustments are required to be made:

(a) There shall be added to the normal-tax net income:

(1) An amount equal to 50 percent of the deduction for interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719 (a)); and

(2) An amount equal to the amount of interest on obligations held during the taxable year which are described in section 22 (b) (4), any part of the interest from which is excludible from gross income or allowable as a credit against net income, if the corporation has elected under section 720 (d) to treat such interest as taxable for excess profits tax purposes. As used in paragraph (2), the term "interest" includes, in the case of obligations issued at a discount, so much of such discount as (for purposes of determining gain or loss upon sale or other disposition) is treated as interest in the hands of the taxpayer for the taxable year. If a taxpayer in its return has made the election under section 720 (d), the amount of interest on obligations held during the taxable year which are described in section 22 (b) (4) shall be reduced by the amount, if any, of the amortizable bond premium under section 125 attributable to such obligations, and only the amount of interest so reduced shall be added to normal-tax net income.

(b) There shall be subtracted from the normal-tax net income the amount of dividends received from foreign corporations on stock which is a capital asset, except dividends (actual or constructive) on stock of foreign personal-holding companies.

The computation of the excess profits net income in cases where the invested capital credit is used may be illustrated by the following example:

Example. The facts present in the example in § 35.711 (a)–2 with respect to the X Corporation are also present with respect to the Y Corporation, and in addition the following facts are present with respect to the latter corporation:

(a) During the calendar year 1942 the corporation pays interest amounting to $48,000 on the bonds referred to in (3) of that example.

(b) Throughout the entire calendar year 1942 the corporation owns $100,000 of Treasury bonds 1944–54 and $100,000 of bonds is-

sued by a State. Neither the Treasury bonds nor the State bonds were purchased at a premium. It derives income for the year 1942 from interest on such bonds amounting to $6,000. The corporation elects under section 720 (d) to increase its normal-tax net income for excess profits tax purposes for the year 1942 by an amount equal to the amount of interest on all obligations held during that year which are described in section 22 (b) (4).

(c) The corporation held as a capital asset the stock on which the dividends were received.

If the invested capital credit is used, the excess profits net income of the corporation for the calendar year 1942 is $324,600, computed as follows:

Normal-tax net income (computed without regard to the credit provided by section 26 (e) for income subject to the excess profits tax)		$400,000
Plus:		
Losses from the sale or exchange of capital assets held for more than six months	$75,000	
50 per cent of interest on indebtedness included in borrowed capital	24,000	
Interest on Government and State obligations	6,000	
		105,000
		505,000
Less:		
Gains from the sale or exchange of capital assets held for more than six months	100,000	
Income from retirement of bonds	20,000	
Income from refunds of Agricultural Adjustment Act taxes and interest thereon	400	
Income from recovery of bad debts	5,000	
Additional dividends received credit ($140,000 dividends received from both domestic and foreign corporations less credit of $85,000 already allowed by section 26 (b) for dividends received)	55,000	
		180,400
Excess profits net income under section 711 (a) (2)		324,600

§ 35.711 (a)-4 *Tax for period of less than 12 months*—(a) *Methods of computing tax for short taxable year; allowance.* Section 711 (a) (3) provides rules, under a general rule and under an exception to such rule, which are applicable to short excess profits tax taxable years for the purpose of determining 12 months' experience and computing the tax for such years. A short taxable year is any taxable period of less than 12 months. If the period from the date of incorporation of a corporation to the end of its first accounting period, or the period from the beginning of its last accounting period to the date it ceases operations and is dissolved, retaining no assets, is a period of less than 12 months, such period is a short taxable year. In every case of a short taxable year, whether of a type resulting from a change of accounting period or of a type described in the preceding sentence, the excess profits net income for a period of 12 months used for the purpose of computing the tax under this section shall be used for all other purposes under this subchapter (except as otherwise expressly provided) as the excess profits net income of the taxpayer for the short taxable year. The tax imposed by section 710 (a) (1) (A) for the short taxable year shall be computed under paragraph (b) of this section, except as otherwise provided in paragraph (c) of this section. The tax under section 710 (a) (1) (B) for a taxable year of less than 12 months is determined on the basis of the actual normal tax and surtax for the taxable year and on the basis of the corporation surtax net income computed for the period for which return was made without placing the net income on an annual basis and computed without regard to the credit provided in section 26 (e) for income subject to excess profits tax.

(b) *General rule.* Section 711 (a) (3) (A) provides that the excess profits net income for a short taxable year shall be placed on an annual basis by multiplying the amount thereof by the number of days in the 12 months ending with the close of the short taxable year and dividing by the number of days in the short taxable year. A tentative tax shall then be computed as though the excess profits net income were the amount so ascertained under the preceding sentence. The actual tax for the short taxable year shall be an amount which bears the same ratio to such tentative tax as the number of days in the short taxable year bears to the total number of days in the 12 months ending with the close of the taxable year.

(c) *Exception; tax for short period determined by actual 12-month adjusted excess profits net income.* If the taxpayer applies to the Commissioner in the manner provided in paragraph (d) of this section to have its tax computed under the provisions of section 711 (a) (3) (B), and if the taxpayer establishes the amount of its adjusted excess profits net income, computed for the 12-month period hereinafter described and under the rules hereinafter prescribed, then section 711 (a) (3) (B) provides that the tax for the short taxable year shall be reduced to an amount which is such part of the tax computed on the basis of the adjusted excess profits net income which the taxpayer has established for such 12-month period as the excess profits net income for the short taxable year is of the excess profits net income for such 12-month period. If such amount, however, is greater than the tax computed under paragraph (b) of this section, the tax for the short taxable year is the tax computed under paragraph (b). The 12-month period referred to above is the 12-month period beginning with the first day of the short taxable year, except that if the taxpayer has disposed of substantially all its assets prior to the end of such 12-month period, then it is the 12-month period ending with the last day of the short taxable year. If a corporation ceases business and distributes so much of the assets used in its business that it cannot resume its customary operations with the remaining assets, it has disposed of substantially all of its assets.

In computing the tax under section 711 (a) (3) (B), the excess profits net income for the short taxable year is not placed on an annual basis as provided in section 711 (a) (3) (A). The adjusted excess profits net income for the 12-month period is computed under the same provisions of law as are applicable to the short taxable year, with the use of the credits applicable in determining the adjusted excess profits net income for such short taxable year (as if this section were not applicable), and is computed as if the 12-month period were an actual accounting period of the taxpayer. All items which fall in such 12-month period must be included even if they are extraordinary in amount or of an unusual nature. The adjustments provided in section 711 (a) (1) and (2) under the law applicable to such short taxable year shall be made upon the basis of the normal-tax net income for such 12-month period. The apportionment of items to such 12-month period shall be made in accordance with the method and principles applicable under § 29.47-2 (b) of this chapter. The excess profits net income for the 12-month period used shall in no case be considered less than the actual excess profits net income for the short taxable year.

(d) *Application to compute tax under section 711 (a) (3) (B).* A taxpayer desiring the benefit of section 711 (a) (3) (B) must file an application therefor. If at the time the return for the short taxable year is filed the taxpayer is able to determine that the 12-month period ending with the close of the short taxable year will be used in the computations under section 711 (a) (3) (B), then the tax on the return for the short taxable year may be determined under the provisions of section 711 (a) (3) (B). In such a case, an excess profits tax return form covering the 12-month period shall be attached to the return as a part thereof, and the return will then be considered the application for the benefits of section 711 (a) (3) (B) required by that section. In all other cases, the taxpayer shall file its return and compute its tax as provided in paragraph (b) of this section, and the application for the benefit of section 711 (a) (3) (B) shall be made in the form of a claim for credit or refund if the tax computed under section 711 (a) (3) (A) has been paid, or, if the tax computed under section 711 (a) (3) (A) has not been paid, the application shall consist of a notice to the Commissioner setting forth the facts involved together with an excess profits tax return form covering the 12-month period used. The claim or other application for the benefit of section 711 (a) (3) (B) shall set forth the com-

putation of the adjusted excess profits net income and the tax thereon for the 12-month period and, if credit or refund is sought for taxes paid before the application for the benefit of section 711 (a) (3) (B) is filed, the claim must be filed not later than June 15, 1943, or the time prescribed for filing the return for the first taxable year (or for the period which would be its taxable year if it continued in existence) ending with or after the twelfth month after the beginning of the short taxable year, whichever date is later. For example, the taxpayer changes its accounting period from the calendar year basis to the fiscal year basis ending September 30, and files a return for the period from January 1, 1942, to September 30, 1942. At the time it files its return, it pays the tax computed thereon under the provisions of section 711 (a) (3) (A). Its claim for credit or refund of the overpayment which would result from the application of section 711 (a) (3) (B) must be filed not later than the time prescribed for filing its return for the first taxable year which ends on or after the last day of December, 1942, the twelfth month after the beginning of the short taxable year. In this case, the taxpayer must file its claim for credit or refund not later than December 15, 1943, the time prescribed for filing the return for its fiscal year ending September 30, 1943. However, if it obtains an extension of time for filing the return for such fiscal year, it may file its claim during the period of such extension. If the Commissioner determines that the taxpayer has established the amount of the adjusted excess profits net income for the 12-month period, any excess of the tax paid for the short taxable year over the tax computed under section 711 (a) (3) (B) will be credited or refunded to the taxpayer in the same manner as in the case of any other overpayment. An application for the benefit of section 711 (a) (3) (B), other than a claim for credit or refund, made in any case in which the tax liability computed under section 711 (a) (3) (A) has not been paid, may be filed at any time before the tax liability for the taxable year is finally determined. Such application does not constitute a claim for credit, refund, or abatement. If credit or refund is sought for taxes paid after such application is filed, a claim therefor on Form 843 should be filed after such payment and within the period prescribed in section 322.

[SEC. 711. EXCESS PROFITS NET INCOME (Added by sec. 201, Second Rev. Act 1940; amended by secs. 3 and 12 (b), Excess Profits Tax Amendments 1941, by sec. 202 (c) and (d), Rev. Act 1941, and by secs. 205 (b) and (c), 206, 207, 208, 209 (a) and (b), 210, 211, and 213, Rev. Act 1942).]

* * * * *

(b) *Taxable years in base period*—(1) *General rule and adjustments.* The excess profits net income for any taxable year subject to the Revenue Act of 1936 shall be the normal-tax net income, as defined in section 13 (a) of such Act; and for any other taxable year beginning after December 31, 1937, and before January 1, 1940, shall be the special-class net income, as defined in section 14 (a) of the applicable revenue law. In either case the following adjustments shall be made (for additional adjustments in case of certain reorganizations, see section 742 (e)):

(A) [Not applicable to taxable years under these regulations (section 202 (c) (2), Rev. Act 1941).]

(B) *Gains and losses from sales or exchanges of capital assets.* There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

(C) *Income from retirement or discharge of bonds, and so forth.* There shall be excluded in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

(D) *Deductions on account of retirement or discharge of bonds, and so forth.* If during the taxable year the taxpayer retires or discharges any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months, the following deductions for such taxable year shall not be allowed:

(i) The deduction allowable under section 23 (a) for expenses paid or incurred in connection with such retirement or discharge;

(ii) The deduction for losses allowable by reason of such retirement or discharge; and

(iii) In case the issuance was at a discount, the amount deductible for such year solely because of such retirement or discharge;

(E) *Casualty, demolition, and similar losses.* Deductions under section 23 (f) for losses arising from fires, storms, shipwreck, or other casualty, or from theft, or arising from the demolition, abandonment, or loss of useful value of property, not compensated for by insurance or otherwise, shall not be allowed;

(F) *Repayment of processing tax to vendees.* The deduction under section 23 (a), for any taxable year, for expenses shall be decreased by an amount which bears the same ratio to the amount deductible on account of any repayment or credit by the corporation to its vendee of any amount attributable to any tax under the Agricultural Adjustment Act of 1933, as amended, as the excess of the aggregate of the amounts so deductible in the base period over the aggregate of the amounts attributable to taxes under such Act collected from its vendees which were includible in the corporation's gross income in the base period and which were not paid, bears to the aggregate of the amounts so deductible in the base period;

(G) *Dividends received.* The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations;

(H) *Payment of judgments, and so forth.* Deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest on any of the foregoing, if abnormal for the taxpayer, shall not be allowed, and if normal for the taxpayer, but in excess of 125 per centum of the average amount of such deductions in the four previous taxable years, shall be disallowed in an amount equal to such excess;

(I) *Intangible drilling and development costs.* Deductions attributable to intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, and for development costs in the case of mines, if abnormal for the taxpayer, shall not be allowed, and if normal for the taxpayer, but in excess of 125 per centum of the average amount of such deductions in the four previous taxable years, shall be disallowed in an amount equal to such excess; and

(J) *Abnormal deductions.* Under regulations prescribed by the Commissioner, with the approval of the Secretary, for the determination, for the purposes of this subparagraph, of the classification of deductions—

(i) Deductions of any class shall not be allowed if deductions of such class were abnormal for the taxpayer, and

(ii) If the class of deductions was normal for the taxpayer, but the deductions of such class were in excess of 125 per centum of the average amount of deductions of such class for the four previous taxable years, they shall be disallowed in an amount equal to such excess.

(K) *Rules for application of subparagraphs (H), (I), and (J).* For the purposes of subparagraphs (H), (I), and (J)—

(i) If the taxpayer was not in existence for four previous taxable years, then such average amount specified in such subparagraphs shall be determined for the previous taxable years it was in existence and the succeeding taxable years which begin before the beginning of the taxpayer's second taxable year under this subchapter. If the number of such succeeding years is greater than the number necessary to obtain an aggregate of four taxable years there shall be omitted so many of such succeeding years, beginning with the last, as are necessary to reduce the aggregate to four.

(ii) Deductions shall not be disallowed under such subparagraphs unless the taxpayer establishes that the abnormality or excess is not a consequence of an increase in the gross income of the taxpayer in its base period or a decrease in the amount of some other deduction in its base period, and is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer.

(iii) The amount of deductions of any class to be disallowed under such subparagraphs with respect to any taxable year shall not exceed the amount by which the deductions of such class for such taxable year exceed the deductions of such class for the taxable year for which the tax under this subchapter is being computed.

(2) *Capital gains and losses.* For the purposes of this subsection the normal-tax net income and the special-class net income referred to in paragraph (1) shall be computed as if section 23 (g) (2), section 23 (k) (2), and section 117 were part of the revenue law applicable to the taxable year the excess profits net income of which is being computed, with the exception that the capital loss carry-over provided in subsection (e) (1) of section 117 shall be applicable to net capital losses for taxable years beginning after December 31, 1934. Such exception shall not apply for the purposes of computing the tax under this subchapter for any taxable year beginning before January 1, 1943.

§ 35.711 (b)-1 *Computation of excess profits net income for taxable years in base period.* If the excess profits credit for the taxable year is computed under section 713, it is necessary to compute the excess profits net income for each taxable year of the base period. The taxable years in the base period are those beginning after December 31, 1935, and before January 1, 1940. For a taxable year beginning after December 31, 1935, and before January 1, 1938, the starting point in the determination of the excess profits net income is the normal-tax net income, as defined in section 13 (a) of the Revenue Act of 1936. For a taxable year beginning after

December 31, 1937, the starting point is the special-class net income, as defined in section 14 (a) of the Revenue Act of 1938 and the Internal Revenue Code.

The normal-tax net income or the special-class net income, as the case may be, is to be adjusted first as required by section 711 (b) (2) and then as required by section 711 (b) (1).

The adjustments required by sections 711 (b) (2) and 711 (b) (1) (B) may be illustrated by the following example:

Example. The normal tax net income of the X Corporation for the calendar year 1936 is $50,000 and its special class net income for the calendar year 1939 is $200,000. In December, 1935, the corporation purchased shares of the stock and bonds of other corporations for a total purchase price of $25,000. The corporations were never included in a consolidated return. Such shares of stock and bonds were capital assets. They became worthless in 1936 and the bonds were charged off during that year. For 1936, the corporation had losses described in section 117 (j) (relating to gains and losses from the sale, exchange, or involuntary conversion of certain property described in that section) which exceeded its gains described in that section by $5,000. All of such gains and losses was derived from the sale of property of a character subject to the allowance for depreciation provided in section 23 (l). For 1939, all gains and losses described in section 117 (j) were again derived from the sale of property of a character subject to the allowance for depreciation provided in section 23 (l), and such gains exceeded such losses by $3,000. In addition to the foregoing gains and losses, the corporation had gains and losses as follows:

	1936	1939
Gains from the sale or exchange of capital assets held for not more than 6 months	$12,000	None
Losses from the sale or exchange of capital assets held for not more than 6 months (disregarding any carry-over)	26,000	None
Gains from the sale or exchange of capital assets held for more than 6 months	10,000	$25,000
Losses from the sale or exchange of capital assets held for more than 6 months	30,000	1,000

For the purpose of computing the income credit applicable to the excess profits tax taxable year of the corporation beginning January 1, 1942, the adjustments required in computing the excess profits net income of the corporation for 1936 and 1939 are as follows:

1936		
Normal-tax net income		$50,000
Adjustment under section 711 (b) (2):		
Add: Deductions for loss on worthless stock and bonds ($25,000) and for capital net loss ($2,000) ($25,000 plus $2,000 or $27,000)		27,000
		77,000
Subtract: Excess of losses described in section 117 (j) over gains described in that section		5,000
Normal-tax net income adjusted as required by section 711 (b) (2)		72,000
(No adjustment is required under section 711 (b) (1) (B) since losses from the sale or exchange of capital assets held for more than six months exceed gains from the sale or exchange of such assets, determined as follows:		
Losses from the sale or exchange of capital assets held for more than 6 months ($25,000 with respect to the worthless stock and bonds and $30,000 with respect to other long-term capital losses)	$55,000	
Gains from the sale or exchange of capital assets held for more than 6 months	10,000	
Net long-term capital losses	45,000	
The adjustments under section 711 (b) (2) in effect excluded such gains and losses from gross income by allowing the deduction of the losses only to the extent of the gains included in gross income.)		
Normal-tax net income adjusted as required by section 711 (b) (2) and section 711 (b) (1) (B)[1]		72,000
1939		
Special class net income		200,000
(No adjustment required under section 711 (b) (2).)		
Adjustments under section 711 (b) (1) (B):		
Gains from the sale or exchange of capital assets held for more than 6 months ($3,000 with respect to the excess of gains from the sale of depreciable property over the losses therefrom and $25,000 with respect to other long-term capital gains)	$28,000	
Losses from the sale or exchange of capital assets held for more than 6 months	1,000	
Deduct net long-term capital gain		27,000
Special class net income adjusted as required by sections 711 (b) (2) and 711 (b) (1) (B)		173,000

[1] Since losses from the sale or exchange of capital assets held for not more than six months exceed the gains from such sales or exchanges, such gains and losses do not enter into the adjustment except insofar as they are reflected in the $2,000 deduction for net capital losses, allowed in computing normal tax net income, which is disallowed under section 711 (b) (2).

The following rules apply to the use of capital loss carry-overs to base period years when computing the income credit applicable to the excess profits tax taxable years indicated below:

(a) If the excess profits tax taxable year begins in 1942, the net short-term capital loss carry-over provided in section 117 (e), prior to its amendment by the Revenue Act of 1942, shall be applicable to net short-term capital losses for taxable years beginning after December 31, 1934, and for the purpose of determining such carry-over capital gains and losses shall be determined as if the provisions of section 23 (g) (2) and (k) (2) and section 117 of the Code (other than section 117 (e)), as amended by the Revenue Act of 1942 were applicable to all of such years. (See Regulations 103 and Part 29 of this chapter.)

(b) If the excess profits tax taxable year begins on or after January 1, 1943, the capital loss carry-over provided in section 117 (e) (1), as amended by the Revenue Act of 1942, shall be applicable to net capital losses for taxable years beginning after December 31, 1934, and for the purpose of determining such carry-over capital gains and losses shall be determined as if the provisions of section 23 (g) (2) and (k) (2) and section 117 of the Code, as amended by the Revenue Act of 1942, were applicable to all of such years. (See Part 29 of this chapter.)

Section 117 (e) (2), as added by the Revenue Act of 1942, has no application for the purposes of computing capital loss carry-overs to base period years.

No adjustment on account of income tax for any base period year shall be made in computing the excess profits tax for the taxable year.

For the purpose of the adjustment under section 711 (b) (1) (C), the applicable number of months beyond which the obligation of the taxpayer must have been outstanding is six months. The applicable number of months beyond which the obligation of the taxpayer must have been outstanding for the purpose of the adjustment under section 711 (b) (1) (D) is 18 months.

In making the adjustments provided in section 711 (b) (1) (D), the deduction allowable for any premium paid on bonds when called for redemption shall be disallowed, but the deduction allowable for any discount amortized up to the date of retirement or discharge shall not be disallowed. Expenses incurred in issuing bonds which are amortized shall be treated in the same manner as discounts. The adjustments required by section 711 (b) (1) (D) may be illustrated by the following example:

Example. The normal-tax net income of the M Corporation for the calendar year 1936 is $75,000. On January 1, 1935, the corporation issued 1,200 non-serial bonds with a total face value of $120,000 at a discount of $14,400, maturing on December 31, 1954. On August 1, 1936, the corporation purchased one-sixth of the amount of the bonds for $19,000. The deduction allowable under section 23 (a) of the Revenue Act of 1936 for expenses paid in connection with such purchase amounted to $1,200. The adjustments required by section 711 (b) (1) (D) in computing the excess profits net income of the corporation for 1936 are as follows:

Normal-tax net income		$75,000
Adjustment under section 711 (b) (1) (D):		
Add:		
(i) Deduction allowable for expenses in connection with retirement	$1,200	
(ii) Deduction for losses allowable by reason of retirement	None	
(iii) Amount deductible because of retirement or discharge of bonds ($1,210 computed as in Schedule below)	1,210	
		2,410
Normal-tax net income adjusted as required by section 711 (b) (1) (D)		77,410

Schedule—	
(*a*) Annual amortization on $14,400 discount ($14,400÷20)	720
(*b*) Annual amortization of discount on block of bonds retired ($720÷6)	120
(*c*) Monthly amortization of discount on block of bonds retired (120÷12)	10
(*d*) Amortized discount deductible on block of bonds retired on August 1, 1936 ($10×19)	190
(*e*) Purchase price of bonds retired on August 1, 1936	19,000
(*f*) Issuing price of bonds retired on August 1, 1936 $\frac{1,200\times\$88}{6}$	17,600
(*g*) Total amount of discount deductible on account of retirement of bonds on August 1, 1936 ($19,000−$17,600)	1,400
(*h*) Amount deductible because of retirement or discharge of bonds (item (*g*) less item (*d*), or $1,400−$190)	1,210

The adjustments required by section 711 (b) (1) (F) may be illustrated by the following example:

Example. The normal-tax net income of the O Corporation for the calendar year 1936 is $75,000. During that year the corporation collected from its vendees $2,000 attributable to taxes under the Agricultural Adjustment Act of 1933, as amended. The $2,000 was included in the gross income of the corporation for 1936 and the taxes to which such amount was attributable were not paid. During the years 1936 and 1937 the corporation repaid to its vendees $6,000 and $2,000, respectively, of amounts it had collected from them for 1936 and prior years attributable to such taxes. It made no such repayments during the years 1938 and 1939. The amount repaid to the vendees in 1936 is deductible from the corporation's gross income for that year. The adjustments required by section 711 (b) (1) (F) in computing the excess profits net income of the corporation for 1936 are as follows:

Normal-tax net income		$75,000
Adjustment under section 711 (b) (1) (F):		
Add: The amount of $4,500, computed as shown in the schedule below		4,500
Normal-tax net income adjusted as required by section 711 (b) (1) (F)		79,500

Schedule—	
(1) Amount deductible under section 23 (a) for 1936 on account of repayment to vendees of amounts collected from vendees attributable to taxes under Agricultural Adjustment Act of 1933, as amended, which were not paid	6,000
(2) Aggregate amounts described in (1) deductible in the base period ($6,000 plus $2,000)	8,000
(3) Aggregate of amounts described in (1) collected from vendees and includible in gross income of corporation in base period	2,000
(4) Excess of (2) over (3) ($8,000 minus $2,000)	6,000
(5) Ratio of (4) to (2)	6/8
(6) Amount of adjustment $\left(\frac{(4)\times(1)}{(2)}\text{ or }\frac{6}{8}\text{ of }\$6,000\right)$	4,500

In connection with the adjustments required to be made by section 711 (b) (1) (H), (I), and (J), see § 35.711 (b)–2.

§ 35.711 (b)–2 *Abnormal deductions in base period.* Adjustments in the excess profits net income for a taxable year in the base period are required in order to disallow deductions of a class which is abnormal for the taxpayer, and to disallow the amount by which deductions of a class normal for the taxpayer exceed 125 percent of the average amount of deductions of such class for the four previous taxable years. If the taxpayer was not in existence for four previous taxable years, then the average amount of deductions of any class shall be determined for the previous taxable years during which it was in existence and the succeeding taxable years which begin before the beginning of the taxpayer's second excess profits tax taxable year. If the number of such succeeding years is greater than the number necessary to obtain an aggregate of four taxable years there shall be omitted so many of such succeeding years, beginning with the last, as are necessary to reduce the aggregate to four. For example, in the case of a corporation coming into existence on January 1, 1938, and making its income tax returns on the calendar year basis, the amount of deductions of any class which may be disallowed for the taxable year 1939 may be determined from the average of the deductions for the taxable years 1938 and 1940. The taxable year 1941 is the taxpayer's second excess profits tax taxable year and therefore may not be used.

A class of deductions is abnormal only if the taxpayer had no deductions of that class in the taxable years prescribed for determining average deductions.

The taxpayer must establish that the abnormality or excessiveness of the deduction is not a consequence of an increase in the gross income of the taxpayer in its base period or a decrease in the amount of some other deduction in its base period, and is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer. For example, if in 1939 the deductions of an airplane manufacturer for wages were in excess of 125 percent of the average of such deductions for the four previous taxable years because of a training program for mechanics instituted by the corporation in 1939 to provide for an expansion in operations, no part of the deductions will be disallowed. If a corporation distributes its product through agents paid commissions on gross sales, and due to a rise in the price of the product, both the amount of gross income and the amount of deductions for commissions increased, any resulting abnormal amount of deductions for commissions will not be disallowed. If the X Gasoline Corporation in 1938 and all prior years deducted gasoline taxes paid by it as a business expense under section 23 (a), but in 1939 included such taxes for that year in its deductions for taxes paid under section 23 (c) so as to increase its deductions for taxes paid for 1939 to an amount in excess of 125 percent of its average deductions of the same class for the four previous taxable years, the abnormal amount of such deduction for 1939 will not be disallowed. As to advertising expenditures, the provisions of section 733 apply before any determinations are made under this section. See § 35.733–3.

In order for the deduction of any class to be disallowed, the deductions of such class for the taxable year in the base period must exceed the deductions of the same class for the taxable year for which the excess profits tax is being computed, and any amount which may be disallowed shall be no greater than the amount by which the deductions of such class for the base period taxable year exceed the deductions of the same class for the taxable year for which the excess profits tax is being computed. For example, if a corporation in the base period taxable year 1938 had a deduction of $200,000 and its average of deductions of the same class for the four previous taxable years was $100,000, the amount of $75,000 ($200,000 minus 125 percent of $100,000) may be disallowed, but only if the deductions of this class in 1938 exceed by this or a greater amount the deductions of the same class in the taxable year for which the excess profits tax is being computed. If the tax is computed for 1942 and the deductions of this class for 1942 are $100,000, the full $75,000 is disallowed for the taxable year 1938. If for 1943 the deductions of this class are $125,000, the full $75,000 may again be disallowed for the taxable year 1938 in computing the excess profits tax for 1943. However, if for 1944 the deductions of this class are $150,000, only $50,000 will be disallowed for the taxable year 1938 in determining the excess profits credit based on income for use against the excess profits net income for 1944. If the excess profits tax taxable year is a taxable year of less than 12 months and the taxpayer places its excess profits net income on an annual basis as provided in section 711 (a) (3) (A) or establishes an

adjusted excess profits net income for a 12-month period, which is used to compute the tax under section 711 (a) (3) (B), the deductions of the class as determined upon such annual basis or under such adjusted excess profits net income for such 12-month period used shall be considered as deductions of the class for the excess profits tax taxable year. Thus, the corporation in the example just given may have changed its accounting period in 1943 from a calendar year to a fiscal year ending September 30. If, in such case, the corporation had $125,000 of deductions of the class for the short taxable year January 1, 1943, through September 30, 1943, but computed its tax under section 711 (a) (3) (B) and established an adjusted excess profits net income for the 12-month period January 1, 1943, through December 31, 1943, with $175,000 of deductions of the class, only $25,000 will be disallowed for the taxable year 1938 in determining the excess profits credit based on income for use against the excess profits net income for 1943.

(a) *Classification of deductions.* Section 711 (b) (1) (H) and (I) sets forth specific classes of deductions, the amount of which in any base period taxable year may be totally disallowed if abnormal for the taxpayer or disallowed to the extent of the excess over 125 percent of the average of such class if normal for the taxpayer. Section 711 (b) (1) (J) permits the classification of other deductions in accordance with these regulations. In any case, the amount of deductions of any class which may be disallowed shall be determined in the manner previously set forth in this section.

Deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest on any of the foregoing are all of the same class. Therefore, in determining in the case of a deduction for a judgment, for example, whether the class of deductions is abnormal or whether the amount thereof for any taxable year is in excess of 125 percent of average deductions of the same class, account must be taken not only of the amount of deductions for judgments, if any, allowed in preceding taxable years, but also of any deductions arising out of claims, awards, and decrees, and interest thereon.

Deductions for intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, and for development costs in the case of mines are all of the same class. Therefore, for the purpose of determining whether the deductions for one taxable year are abnormal or in excess of 125 percent of average deductions of this class, and for the purpose of determining the amount to be disallowed in such event, reference must be made to the deductions of the entire class, rather than to any particular deductible items included therein. Deductions attributable to the operation of wells or mines are not included in this class.

Deductions which do not fall within either of the classes specified in section 711 (b) (1) (H) and (I) may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such other classes as are reasonable in a business of the type which the taxpayer conducts, and are appropriate in the light of the taxpayer's business experience and accounting practice. Such a classification will be applicable to all other taxable years considered at any time in adjusting deductions under this section, and must be consistent with any classification made by the taxpayer under the provisions of section 721 and section 722.

(b) *Statement required.* If in computing its excess profits net income for a taxable year in the base period, the taxpayer claims the disallowance under section 711 (b) (1) (H), (I), or (J) of any amount previously allowed as a deduction, there shall be submitted a full statement showing the computation of the amount to be disallowed, the prices and gross sales of the taxpayer's product, and the condition of the taxpayer's business which demonstrate that the disallowed amount is not a consequence of an increase in the gross income of the taxpayer in its base period or a decrease in the amount of some other deduction in its base period, and is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer. This statement shall be in duplicate and shall include the following: (1) the computation of the amount disallowed, showing the amount of the class of deductions in the base period taxable year for which any part of such amount is disallowed, the average amount of such class for the four preceding taxable years or for such taxable years as the taxpayer is required to use in determining this average amount, and the excess amount of deductions disallowed; (2) a description and the amount of each item included in such class of deductions for the taxable year for which such deductions are disallowed and for the taxable years in the test period, with the amount of each and a description thereof; (3) the amount of such class and the amount and description of each item in that class for the taxable year for which the excess profits tax is being computed; and (4) all other facts upon which the taxpayer relies.

SEC. 712. EXCESS PROFITS CREDIT—ALLOWANCE. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 13, Excess Profits Tax Amendments 1941, and by secs. 212 (a), 224 (b), and 228 (e), Rev. Act 1942.]

(a) *Domestic corporations.* In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in case of certain reorganizations of corporations, see section 741.)

(b) *Foreign corporations.* In the case of a foreign corporation engaged in trade or business within the United States, the first taxable year of which under this subchapter begins on any date in 1940, which was in existence on the day forty-eight months prior to such date and which at any time during each of the taxable years in such forty-eight months was engaged in trade or business within the United States, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other foreign corporations the excess profits credit for any taxable year shall be an amount computed under section 714.

(c) [Not applicable to taxable years under these regulations (section 224 (b), Rev. Act 1942).]

(d) *Special rule in connection with certain reorganizations.* For the existence of taxpayer through component corporations, see section 740 (f).

§ 35.712–1 *Excess profits credit; allowance.* (a) Two methods are provided for computing the excess profits credit: (1) The income method under which the credit is computed as provided in section 713, and (2) the invested capital method under which the credit is computed as provided in section 714.

(b) In the case of the following corporations, the excess profits credit shall be the credit based upon income, computed as provided in section 713, or the credit based on invested capital, computed as provided in section 714, whichever credit results in the lesser tax for the taxable year for which the tax is being computed:

(1) A domestic corporation which was actually in existence before January 1, 1940.

(2) A domestic corporation which was not actually in existence before January 1, 1940, but which, as an acquiring corporation within the meaning of section 740 of Supplement A, was constructively in existence before January 1, 1940. (For computation of excess profits credit based on income in the case of an acquiring corporation, see sections 740 to 744.)

(3) A foreign corporation (i) which is engaged in trade or business within the United States at any time during the taxable year; (ii) the first taxable year of which for the purposes of the excess profits tax begins on any day in 1940; (iii) which was in existence on the date 48 months prior to such date; and (iv) which, at any time during each of the taxable years in such 48 months, was engaged in trade or business within the United States. As to what constitutes being engaged in trade or business within the United States, see § 29.231–1 of this chapter.

(c) The following corporations are required to compute their credit under the invested capital method provided in section 714:

(1) A domestic corporation which is not an acquiring corporation within the meaning of section 740 of Supplement A and which was not actually in existence before January 1, 1940.

(2) A domestic corporation which is an acquiring corporation within the meaning of section 740 of Supplement A and which was not actually or constructively in existence before January 1, 1940.

(3) A foreign corporation which does not meet the requirements of paragraph (b) (3) above.

However, in certain cases where the excess profits credit based on invested capital is an inadequate standard for determining excess profits, for allowance of an excess profits credit based on income, using a constructive average base period net income, see section 722 (c) and § 35.722–4.

SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 4, Excess Profits Tax Amendments 1941, and by secs. 214 (a), 215, 216, and 228 (e), Rev. Act 1942.]

(a) *Amount of excess profits credit.* The excess profits credit for any taxable year, computed under this section, shall be—

(1) *Domestic corporations.* In the case of a domestic corporation—

(A) 95 per centum of the average base period net income,

(B) Plus 8 per centum of the net capital addition as defined in subsection (g), or

(C) Minus 6 per centum of the net capital reduction as defined in subsection (g).

(2) *Foreign corporations.* In the case of a foreign corporation, 95 per centum of the average base period net income.

(b) *Base period*—(1) *Definition.* As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

(B) In the case of a corporation which was in existence during only part of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the forty-eight months preceding the beginning of its first taxable year under this subchapter.

(2) *Division into halves.* For the purposes of subsections (d) and (f) the base period of the taxpayer shall be divided into halves, the first half to be composed of one-half the entire number of months in the base period and to begin with the beginning of the base period.

(c) *Deficit in excess profits net income.* For the purposes of this section the term "deficit in excess profits net income" with respect to any taxable year means the amount by which the deductions plus the credit for dividends received and the credit provided in section 26 (a) (relating to interest on certain obligations of the United States and its instrumentalities) exceeded the gross income. For the purposes of this subsection in determining whether there was such an excess and in determining the amount thereof, the adjustments provided in section 711 (b) (1) shall be made.

(d) *Average base period net income—Determination*—(1) *Definition.* For the purposes of this section the average base period net income of the taxpayer shall be the amount determined under subsection (e), subject to the exception that if the aggregate excess profits net income for the last half of its base period, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (f), if greater than the amount determined under subsection (e).

(2) For the purposes of subsections (e) and (f), if the taxpayer was in existence during only part of the 48 months preceding the beginning of its first taxable year under this subchapter, its excess profits net income—

(A) for each taxable year of twelve months (beginning with the beginning of its base period) during which it was not in existence, shall be an amount equal to 8 per centum of the excess of—

(i) the daily invested capital for the first day of the taxpayer's first taxable year beginning after December 31, 1939, over

(ii) an amount equal to the same percentage of such daily invested capital as is applicable under section 720 in reduction of the average invested capital of the preceding taxable year;

(B) for the taxable year of less than twelve months consisting of that part of the remainder of its base period during which it was not in existence, shall be the amount ascertained for a full year under subparagraph (A), multiplied by the number of days in such taxable year of less than twelve months and divided by the number of days in the twelve months ending with the close of such taxable year.

(3) In no case shall the average base period net income be less than zero.

(4) For the computation of average base period net income in the case of certain reorganizations, see section 742.

(e) *Average base period net income—General average.* The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number of months in such other taxable years (herein called "average monthly amount") the amount used for such one year under this paragraph shall be 75 per centum of the average monthly amount multiplied by the number of months in such one year, and the year increased under this sentence shall be the year the increase in which will produce the highest average base period net income;

(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

(3) By multiplying the amount ascertained under paragraph (2) by twelve.

(f) *Average base period net income—Increased earnings in last half of base period.* The average base period net income determined under this subsection shall be determined as follows:

(1) By computing, for each of the taxable years of the taxpayer in its base period, the excess profits net income for such year, or the deficit in excess profits net income for such year;

(2) By computing for each half of the base period the aggregate of the excess profits net income for each of the taxable years in such half, reduced, if for one or more of such years there was a deficit in excess profits net income, by the sum of such deficits. For the purposes of such computation, if any taxable year is partly within each half of the base period there shall be allocated to the first half an amount of the excess profits net income or deficit in excess profits net income, as the case may be, for such taxable year, which bears the same ratio thereto as the number of months falling within such half bears to the entire number of months in such taxable year; and the remainder shall be allocated to the second half;

(3) If the amount ascertained under paragraph (2) for the second half is greater than the amount ascertained for the first half, by dividing the difference by two;

(4) By adding the amount ascertained under paragraph (3) to the amount ascertained under paragraph (2) for the second half of the base period;

(5) By dividing the amount found under paragraph (4) by the number of months in the second half of the base period and by multiplying the result by twelve;

(6) The amount ascertained under paragraph (5) shall be the average base period net income determined under this subsection, except that the average base period net income determined under this subsection shall in no case be greater than the highest excess profits net income for any taxable year in the base period. For the purpose of such limitation if any taxable year is of less than twelve months, the excess profits net income for such taxable year shall be placed on an annual basis by multiplying by twelve and dividing by the number of months included in such taxable year.

(7) For the purposes of this subsection, the excess profits net income for any taxable year ending after May 31, 1940, shall not be greater than an amount computed as follows:

(A) By reducing the excess profits net income by an amount which bears the same ratio thereto as the number of months after May 31, 1940, bears to the total number of months in such taxable year; and

(B) By adding to the amount ascertained under subparagraph (A) an amount which bears the same ratio to the excess profits net income for the last preceding taxable year as such number of months after May 31, 1940, bears to the number of months in such preceding year. The amount added under this subparagraph shall not exceed the amount of the excess profits net income for such last preceding taxable year.

(C) If the number of months in such preceding taxable year is less than such number of months after May 31, 1940, by adding to the amount ascertained under subparagraph (B) an amount which bears the same ratio to the excess profits net income for the second preceding taxable year as the excess of such number of months after May 31, 1940, over the number of months in such preceding taxable year bears to the number of months in such second preceding taxable year.

(g) *Adjustments in excess profits credit on account of capital changes.* For the purposes of this section: (1) The net capital addition for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital addition for each day of the taxable year over the aggregate of the daily capital reduction for each day of the taxable year.

(2) The net capital reduction for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital reduction for each day of the taxable year over the aggregate of the daily capital addition for each day of the taxable year.

(3) The daily capital addition for any day of the taxable year shall be the aggregate of the amounts of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day. In determining the amount of any property paid in, such property shall be included in an amount determined in the manner provided in section 718 (a) (2). A distribution by the taxpayer to its shareholders in its stock or rights to acquire its stock shall not be regarded as money or property paid in for stock, or as paid in surplus, or as a contribution to capital. The amount ascertained under this paragraph shall be reduced by the excess, if any, of the excluded capital for such day over the excluded capital for the first day of the taxpayer's first taxable year under this subchapter. For the purposes of this paragraph the excluded capital for any day shall be an amount equal to the sum of the following:

(A) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day, of obligations held by the taxpayer at the beginning of such day, which are described in section 22 (b) (4) (A), (B), or (C) any part of the interest from which is excludible from gross income or allowable as a credit against net income; and

(B) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day, of stock of domestic corporations held by the taxpayer at the beginning of such day.

The daily capital addition shall in no case be less than zero. (For daily capital additions and reductions in case of certain reorganizations, see section 743.)

(4) The daily capital reduction for any day of the taxable year shall be the aggregate of the amounts of distributions to shareholders, not out of earnings and profits, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day.

(5) If, on any day of the taxable year, the taxpayer and any one or more other corporations are members of the same controlled group, then the daily capital reduction of the taxpayer for such day shall be increased by whichever of the following amounts is the lesser:

(A) The aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) acquired by the taxpayer after the beginning of the taxpayer's first taxable year under this subchapter, minus the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) disposed of by the taxpayer prior to such day and after the beginning of the taxpayer's first taxable year under this subchapter; or

(B) The excess of the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in all domestic corporations and of obligations described in section 22 (b) (4), held by the taxpayer at the beginning of such day over the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in all domestic corporations and of obligations described in section 22 (b) (4), held by the taxpayer at the beginning of its first taxable year under this subchapter.

If any stock or obligations described in subparagraph (A) or (B) was disposed of prior to such day, its basis shall be determined under the law applicable to the year in which so disposed of. The excluded capital of the taxpayer for such day shall be reduced by the amount by which the taxpayer's daily capital reduction for such day is increased under this paragraph. As used in this paragraph, a controlled group means one or more chains of corporations connected through stock ownership with a common parent corporation if (i) more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock, of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations and (ii) the common parent corporation owns directly more than 50 per centum of the total value of shares of all classes of classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock, of at least one of the other corporations.

§ 35.713–1 *Excess profits credit based on income—determination of average base period net income*—(a) *Introductory.* In order for a corporation to determine for any particular taxable year the amount of its excess profits credit based on income, it is necessary first to compute the amount of the average base period net income, 95 percent of which is the starting point for computing the excess profits credit based on income. Two methods are provided for determining the average base period net income: (1) The general average method, set forth in section 713 (e) and in paragraph (b) of this section, and (2) the method set forth in section 713 (f) and in paragraph (c) of this section, applicable to cases in which the earnings for the last half of the base period are greater than those for the first half, if such method results in a greater average base period net income than that resulting from the use of the general average method.

(b) *Computation under the general average method.* The following steps are required for the computation of the average base period net income under the general average method (for computation of excess profits net income for portions of its base period during which the corporation was not in existence, see paragraph (d) of this section, and for certain limitations upon the average base period net income of a component corporation (as defined in section 740 (b)), see § 35.740–2 (c)):

(1) The excess profits net income, or deficit in excess profits net income, for each of the taxable years in the base period (years beginning after December 31, 1935, and before January 1, 1940) is to be determined as provided in section 711 (b). The "deficit in excess profits net income" for any taxable year is the excess of deductions plus the credit for dividends received plus the credit for interest received allowed by section 26 (a) over gross income. If the amount of the excess profits net income or the deficit in excess profits net income, as the case may be, for one taxable year in the base period, when divided by the number of months in such year, is less than 75 percent of the average monthly amount (for the other taxable years in the base period), there shall be substituted for the amount for such one year an amount of excess profits net income equal to 75 percent of such average monthly amount multiplied by the number of months in such year. The year to be increased under this provision is the year the increase in which will produce the highest average base period net income. The "average monthly amount" referred to is the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number of months in such other taxable years.

(2) The aggregate of the excess profits net income for the taxable years in the base period, determined with respect to each year as provided in (1) above, disregarding any taxable year for which (after the application of (1) above) the excess profits net income is less than zero, is to be computed.

(3) From such aggregate amount there is to be deducted the sum of the deficits in excess profits net income, excluding a deficit for which an amount of income has been substituted as provided in (1) above.

(4) Such aggregate amount as so reduced is to be divided by the number of months in the taxable years in the base period and the quotient so obtained is to be multiplied by 12. In no case shall the average base period net income be less than zero.

If the base period is composed solely of 4 taxable years of 12 months each, the base period year which may be adjusted under section 713 (e) (1) is the year of the lowest amount, i. e., the lowest excess profits net income or the greatest deficit. If the base period is more or less than 48 months, or is composed of more than 4 taxable years, the base period year the increase in the amount of which will product the highest average base period net income and which may be adjusted accordingly under section 713 (e) (1) must be determined by a test upon the facts of the case.

The computation of the average base period net income may be illustrated by the following examples:

Example (1). The excess profits net income, credit for interest received, credit for dividends received, deductions, and gross income (all computed by making the adjustments provided in section 711 (b)) of the X Corporation (a domestic corporation), for the years 1936 to 1939, are as follows:

	1936	1937	1938	1939
Excess profits net income	$100,000	−$100,000	−$60,000	$30,000
Credit for interest received	10,000	10,000	10,000	10,000
Credit for dividends received	20,000	40,000	25,000	30,000
Deductions	60,000	150,000	150,000	90,000
Gross income	190,000	100,000	125,000	160,000

The average base period net income of the corporation is $21,875, computed as follows:

(i) Amount (excess profits net income or deficit) for taxable year in which increase under section 713 (e) (1) will produce highest average base period net income (calendar year 1937)	−$100,000
(ii) Average monthly deficit for 1937 (−$100,000÷12)	−8,333
(iii) Aggregate for other taxable years in base period of excess profits net income reduced by deficits in excess profits net income ($100,000+$30,000−$60,000)	70,000
(iv) 75 percent of average monthly amount ($70,000÷36, the number of months in the taxable years in the base period other than 1937) multiplied by the number of months in 1937. This amount is the substitute amount for 1937 (75 percent of $\frac{\$70,000}{36}\times 12$)	17,500

(v) Aggregate of excess profits net income for taxable years in base period (other than those years for which there is a deficit in such income) before reduction required by section 713 (e) (1) ($100,000+$17,500+$30,000)	$147,500
(vi) Amount item (v) above is to be reduced as required by section 713 (c) and (e) (1), i. e., deficit in excess profits net income for 1938	60,000
(vii) Aggregate of excess profits net income for taxable years in base period as reduced (item (v) minus item (vi))	87,500
(viii) Average base period net income, $87,500 (item (vii)) divided by 48 (total number of months in taxable years in base period), multiplied by 12, or $\frac{\$87,500}{48}\times 12$	21,875

Example (2). The excess profits net income (or deficit in excess profits net income) credit for interest received, credit for dividends received, deductions, and gross income (all computed by making the adjustments provided in section 711 (b)) of the Y Corporation (a domestic corporation), for its taxable years beginning in the base period (the calendar years 1936 and 1937, the short-period year January 1, 1938, through June 30, 1938, resulting from a change from the calendar year to a fiscal year, and the fiscal years ending June 30, 1939, and June 30, 1940) are as follows:

	Calendar year 1936	Calendar year 1937	Short period year 1938	Fiscal year 1939	Fiscal year 1940
Excess profits net income	$100,000	−$60,000	−$60,000	−$40,000	$25,200
Credit for interest received	10,000	10,000	5,000	10,000	10,000
Credit for dividends received	20,000	25,000	15,000	20,000	20,000
Deductions	60,000	150,000	100,000	130,000	144,800
Gross income	190,000	125,000	60,000	120,000	200,000

The average base pericd net income of the corporation is $6,800, computed as follows:

(i) Amount (excess profits net income or deficit) for taxable year in which increase under section 713 (e) (1) will produce highest average base period net income (calendar year 1937)	−$60,000
(ii) Average monthly deficit for 1937 (−$60,000÷12)	−5,000
(iii) Aggregate for other taxable years in base period of excess profits net income reduced by deficits in excess profits net income ($100,000+$25,200−$60,000 −$40,000)	25,200
(iv) Average monthly amount ($25,200÷42 (total number of months in taxable years in base period other than 1937))	600
(v) 75 percent of amount in (iv)	450
(vi) Amount of excess profits net income to be used for 1937 (12×$450)	5,400
(vii) Aggregate of excess profits net income for taxable years in base period (other than those years for which there is a deficit in such income), before reduction required by sections 713 (e) (1) ($100,000+$5,400+$25,200)	130,600
(viii) Amount item (vii) above is to be reduced as required by section 713 (c) and (e) (1), i. e., sum of deficits in excess profits net income ($60,000+$40,000)	100,000
(ix) Aggregate of excess profits net income for taxable years in base period as reduced (item (vii) minus item (viii))	30,600
(x) Average base period net income, $30,600 (item (ix)), divided by 54 (total number of months in taxable years in base period), multiplied by 12, or $\frac{\$30,600}{54}\times 12$	6,800

(c) *Computation under section 713 (f); increased earnings in last half of base period.* The determination of the base period net income under the method set forth in section 713 (f) is operative only if the aggregate excess profits net income for the last half of the base period of the taxpayer, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half and the average base period net income determined under section 713 (f) is greater than the amount determined under section 713 (e). The following steps are required for the computation of the average base period net income under the method set forth in section 713 (f).

(1) The excess profits net income or the deficit in excess profits net income for each of the taxable years in the base period (years beginning after December 31, 1935, and before January 1, 1940) is to be determined as provided in section 711 (b).

(2) The base period is to be divided into halves, each of an equal number of months. There is to be computed for each half of the base period the aggregate of the excess profits net income for each of the taxable years in such half, reduced, if for one or more of such years there was a deficit in excess profits net income, by the sum of such deficits. In making this computation, no substitute amount of excess profits net income is to be used for any taxable year as in the case of the general average method under section 713 (e) (1).

(3) The excess of the amount ascertained for the second half over the amount ascertained for the first half is to be divided by 2.

(4) The amount ascertained under paragraph (3) is to be added to the amount ascertained under paragraph (2) for the second half of the base period.

(5) The amount found under paragraph (4) is to be divided by the number of months in the second half of the base period and the result multiplied by 12.

(6) The amount ascertained under paragraph (5) shall be average base period net income determined under the method set forth in section 713 (f), except that the average base period net income so determined shall in no case be greater than the highest excess profits net income for any taxable year in the base period. For the purpose of this limitation if any taxable year is less than 12 months, the excess profits net income for such taxable year shall be placed on an annual basis by multiplying by 12 and dividing by the number of months included in such taxable year. For a restriction upon this limitation in the case of a component corporation, see § 35.740–2 (c).

The computation of the average base period net income under the method set forth in section 713 (f) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has the following amounts of excess profits net income for the taxable years in its base period: 1936, $100,000; 1937, $200,000; 1938, $300,000; and 1939, $400,000. Its average base period net income under the method set forth in section 713 (f) is $400,000, computed as follows:

(1) Aggregate of excess profits net income for taxable years in second half of base period ($300,000 plus $400,000)	$700,000
(2) Aggregate of excess profits net income for taxable years in first half of base period ($100,000 plus $200,000)	300,000
(3) Item (1) less item (2) ($700,000 minus $300,000)	400,000
(4) Item (3) divided by 2 ($400,000 divided by 2)	200,000
(5) Sum of item (1) plus item (4) ($700,000 plus $200,000)	900,000
(6) Item (5) placed on annual basis by dividing it by number of months in second half of base period and multiplying by 12 (($900,000 divided by 24) multiplied by 12)	450,000
(7) Highest excess profits net income for any taxable year in base period (1939)	400,000
(8) Average base period net income (item (7) since such item is less than item (6))	400,000

The provision of section 713 (f) (2) relative to the manner of computation of the aggregate excess profits net income for each half of the base period where the taxpayer, because of changes in its accounting period or for other reasons, has more or less than four taxable years in such period, and where part of one taxable year is in the first half and the other part is in the second half of such period, may be illustrated by the following example:

Example. A corporation has taxable years in its base period and excess profits net incomes for such years as follows:

Years in base period		Number of months	Excess profits net income
Beginning—	Ending—		
Sept. 1, 1936	Aug. 31, 1937	12	$30,000
Sept. 1, 1937	Dec. 31, 1937	4	20,000
Jan. 1, 1938	Dec. 31, 1938	12	60,000
Jan. 1, 1939	Dec. 31, 1939	12	100,000
Total		40	210,000

The aggregate excess profits net income for the first half of the base period is $70,000,

and for the second half it is $140,000, computed as follows:

	Number of months	Excess profits net income
FIRST HALF		
The taxable year beginning Sept. 1, 1936, and ending Aug. 31, 1937	12	$30,000
The taxable year beginning Sept. 1, 1937, and ending Dec. 31, 1937	4	20,000
One-third of the taxable year beginning Jan. 1, 1938, and ending Dec. 31, 1938	4	20,000
Total	20	70,000
SECOND HALF		
Two-thirds of the taxable year beginning Jan. 1, 1938, and ending Dec. 31, 1938	8	40,000
The taxable year beginning Jan. 1, 1939, and ending Dec. 31, 1939	12	100,000
Total	20	140,000

For the purpose of computing the average base period net income thereunder, section 713 (f) (7) provides certain limitations on the amount of the excess profits net income for any taxable year in the base period ending after May 31, 1940.

Section 713 (f) (7) (A) and (B) may be illustrated by the following example:

Example. The Y Corporation makes its income tax returns on the basis of the fiscal year ending September 30. It had an excess profits net income of $400,000 for the fiscal year ended September 30, 1939. It had an excess profits net income of $600,000 for the fiscal year ended September 30, 1940, before the application of section 713 (f) (7) (A) and (B). Both of these taxable years are in its base period but four months of the fiscal year ended September 30, 1940, are after May 31, 1940. Under section 713 (f) (7) (A) and (B) the excess profits net income of the corporation for the fiscal year beginning October 1, 1939, and ended September 30, 1940, is $533,333.33, computed as follows:

(1) Excess profits net income before application of section 713 (f) (7) (A) and (B)	$600,000.00	
(2) Amount by which item (1) is to be reduced under section 713 (f) (7) (A) (four-twelfths of $600,000)	200,000.00	
(3) Item (1) less item (2) ($600,000 minus $200,000)		400,000.00
(4) Amount to be added to item (3) under section 713 (f) (7) (B) (four-twelfths of $400,000)		133,333.33
(5) Excess profits net income for fiscal year ended September 30, 1940, after application of section 713 (f) (7) (item (3) plus item (4), $400,000 plus $133,333.33)		533,333.33

Section 713 (f) (7) (C) may be illustrated by the following example:

Example. The last three taxable years in the base period of the Z Corporation and the number of months in, and the excess profits net income for, such taxable years are as follows:

Taxable years		Number of months	Excess profits net income
Beginning—	Ending—		
July 1, 1938	June 30, 1939	12	$400,000
July 1, 1939	Sept. 30, 1939	3	75,000
Oct. 1, 1939	Sept. 30, 1940	12	600,000

Under section 713 (f) (7) the excess profits net income of the corporation for the fiscal year ended September 30, 1940, $508,333.33, computed as follows:

(1) Excess profits net income before application of section 713 (f) (7) (A) and (B)	$600,000.00	
(2) Amount by which item (1) is to be reduced under section 713 (f) (7) (A) (four-twelfths of $600,000)	200,000.00	
(3) Item (1) less item (2) ($600,000 minus $200,000)		400,000.00
(4) Amount to be added to item (3) under section 713 (f) (7) (B) (four-thirds of $75,000 but not in excess of $75,000)		75,000.00
(5) Amount to be added to item (3) under section 713 (f) (7) (C) (one-twelfth of $400,000)		33,333.33
(6) Excess profits net income for fiscal year ended September 30, 1940, after application of section 713 (f) (7) (sum of items (3), (4), and (5), or $400,000 plus $75,000 plus $33,333.33)		508,333.33

(d) *Computation of excess profits net income for portions of base period during which corporation was not in existence; applicable both under sections 713 (e) and 713 (f).* The base period of a corporation which was in existence during only part of the 48-month period preceding the beginning of its first excess profits tax taxable year is such period of 48 months. Section 713 (d) (2) provides a method for determining the excess profits net income for such a corporation for that portion of such base period during which it was not in existence. For each taxable year of 12 months (beginning with the beginning of the base period) during which it was not in existence the excess profits net income is 8 per cent of the corporation's daily invested capital (see section 717) for the first day of its first excess profits tax taxable year reduced on account of inadmissible assets by the same ratio as would be applicable under section 720 in reduction of its average invested capital for the preceding taxable year. The excess profits net income for a taxable year of less than 12 months consisting of that part of the remainder of the base period during which it was not in existence is a proportionate part of such amount. The provisions of this paragraph may be illustrated by the following example:

Example. The Z Corporation, a domestic corporation which makes its income tax returns on the calendar year basis, was organized on July 1, 1937. The daily invested capital of the corporation for January 1, 1940, is $200,000. The percentage of such invested capital which would be applicable under section 720 in reduction of the average invested capital of the corporation on account of inadmissible assets for the calendar year 1939 is 5.

The excess profits net income of the Z Corporation for 1936 is $15,200, and for the period January 1, 1937, to June 30, 1937, $7,537.53, computed as follows:

(1) Daily invested capital for January 1, 1940	$200,000.00
(2) Amount equal to the same percentage (5 per cent) of item (1) as is applicable under section 720 in reduction of the average invested capital for preceding taxable year, 1939 ($200,000 multiplied by 0.05)	10,000.00
(3) Excess of item (1) over item (2)	190,000.00
(4) Excess profits net income for 1936 ($190,000 multiplied by 0.08)	15,200.00
(5) Excess profits net income for period from January 1, 1937, to June 30, 1937 $\left(\frac{\$15,200 \times 181}{365}\right)$	7,537.53

§ 35.713–2 *Excess profits credit based on income; adjustments in excess profits credit on account of capital changes—* (a) *General.* Under the income method of determining the excess profits credit it is necessary to make adjustments for capital changes since the beginning of the first excess profits tax taxable year.

The amount representing 95 percent of the average base period net income which is the starting point in the computation of the excess profits credit shall be increased by 8 percent of the net capital addition or reduced by 6 percent of the net capital reduction. No capital adjustments are permitted or required in the case of a foreign corporation. Capital additions are money and property paid in for stock, or as paid-in surplus, or as a contribution to capital after the beginning of the first excess profits tax taxable year, adjusted for increases in excluded capital over the same period. Capital reductions are (1) distributions since the beginning of the first excess profits tax taxable year which are not out of earnings and profits; and (2) increased holdings since the beginning of the first excess profits tax taxable year of stock in another corporation which is a member of a controlled group of corporations of which the taxpayer is also a member, limited as provided in section 713 (g) (5) (B). The term "earnings and profits" includes earnings and profits of the taxable year and the accumulated earnings and profits of the corporation, whether accumulated before, on, or after March 1, 1913. For capital additions and reductions in case of certain reorganizations, see section 743.

(b) *Computation of net capital addition.* Computation of net capital addition is illustrated by the following example:

Example. On January 1, 1940, the X Corporation, which makes its income tax returns on the calendar year basis, owns stock (but not more than 50 percent) in another domestic corporation, acquired in 1938, the adjusted basis of which is $10,000 and $30,000 of State bonds which it had purchased in 1938 for $32,000.

The following were the only changes which occurred during the period 1940–1944, inclusive, that would affect the determination of the net capital additional or the net capital reduction of the corporation:

(1) On April 1, 1944 there was paid into the corporation for shares of its stock real estate having a basis to the corporation of $30,000.

(2) On July 1, 1944, there was paid into the corporation for shares of its stock Treasury bonds having a basis to the corporation of $22,400 and cash in the amount of $36,600.

The net capital addition of the corporation for 1944 is $40,759.02, computed as follows:

Period April 2, 1944, to July 1, 1944, inclusive	
(1) Real estate paid in for stock April 1 ,1944	$30,000.00
(2) Less: Excess of excluded capital for each day of period over excluded capital on January 1, 1940 [1]	None
(3) Daily capital addition for each day of period (item (1) minus item (2))	30,000.00
(4) Aggregate of daily capital additions for period ($30,000 multiplied by 91, number of days in period)	2,730,000.00
Period July 2, 1944, to December 31, 1944, inclusive	
(5) Real estate, as above	$30,000.00
(6) Treasury bonds paid in for stock July 1, 1944	22,400.00
(7) Cash paid in for stock July 1, 1944	36,600.00
(8) Total	89,000.00
(9) Less: Excess of excluded capital for each day of period over excluded capital on January 1, 1940 [2]	22,400.00
(10) Daily capital addition for each day of period (item (8) minus item (9))	66,600.00
(11) Aggregate of daily capital additions for period ($66,600 multiplied by 183, number of days in period)	12,187,800.00
(12) Aggregate of daily capital additions for 1944 (item (4) plus item (11))	14,917,800.00
(13) Net capital addition ($14,917,800 divided by 366, number of days in taxable year)	40,759.02

[1] (i) Excluded capital for each day of period:	
(A) Stock of domestic corporations	$10,000
(B) State bonds	32,000
Total	42,000
(ii) Excluded capital for January 1, 1940:	
(A) Stock of domestic corporations	10,000
(B) State bonds	32,000
Total	42,000
(iii) Excess of excluded capital for each day of period over excluded capital on January 1, 1940	None
[2] (i) Excluded capital for each day of period:	
(A) Stock of domestic corporations	$10,000
(B) State bonds	32,000
(C) Treasury bonds	22,400
Total	64,400
(ii) Excluded capital for January 1, 1940	42,000
(iii) Excess of excluded capital for each day of period over excluded capital on January 1, 1940 ($64,400 minus $42,000)	22,400

(c) *Computation of net capital reduction on account of distributions under section 713 (g) (4).* Computation of net capital reduction in a case to which only section 713 (g) (4) applies is illustrated by the following example:

Example. The Y Corporation, a domestic corporation which makes its income tax returns on the calendar year basis, was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. Each share of preferred stock is entitled to receive annual dividends of $7, and $100 on complete liquidation, in priority to any payments on common stock, and is entitled to participate equally with each share of the common stock in either instance after the common stock has received a similar amount. The preferred stock is redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. The preferred stock was issued at $106 per share for a total of $106,000, and the common stock was issued at $100 per share for a total of $200,000. On July 1, 1944, the company had a paid-in surplus of $6,000, consisting of the premium received on the preferred stock, earnings and profits of $30,000 accumulated prior to March 1, 1913, and earnings and profits accumulated since February 28, 1913, of $75,000. On July 1, 1944, the option with respect to the preferred stock is exercised and the entire amount of such stock is redeemed at $141 per share for a total of $141,000, such transaction being a partial liquidation under section 115 (c). The corporation has no other transactions during the year 1944 which affect the capital of the corporation.

The net capital reduction of the corporation for 1944 is $53,000, computed as follows:

(1) Total amount distributed to preferred shareholders		$141,000
(2) Allocation of the amount distributed:		
(i) Attributable to par value	$100,000	
(ii) Attributable to paid-in surplus	6,000	
(iii) Attributable to earnings and profits accumulated as of July 1, 1944 (one-third of ($30,000 plus $75,000))	35,000	
Total	141,000	
(3) Amount of distribution not out of earnings and profits ($100,000 plus $6,000)		106,000
(4) Aggregate of the daily capital reduction from July 2, 1944, to December 31, 1944, both dates inclusive ($106,000 multiplied by 183, number of days in taxable year after distribution)		19,396,000
(5) Net capital reduction ($19,398,000 divided by 366, number of days in taxable year)		53,000

(d) *Computation of capital reduction and excluded capital in case of increased holding of stock of controlled corporation.* Section 713 (g) (5) provides that if on any day of the taxable year a taxpayer and one or more other corporations are members of the same controlled group, the increase in the taxpayer's holdings in the stock of such other corporation or corporations since the beginning of the taxpayer's first excess profits tax taxable year and before the beginning of such day shall be a daily capital reduction of the taxpayer for such day, except as limited by (2) below. The amount of such daily capital reduction (or the amount by which the taxpayer's daily capital reduction for such day is to be increased) on account of such stock is the lesser of the amounts determined by two rules:

(1) The first rule provides that the amount of such increase shall equal the aggregate of the adjusted basis (for determining loss upon sale or exchange) of the stock in such other corporation or corporations acquired by the taxpayer after the beginning of the taxpayer's first excess profits tax taxable year, minus the aggregate of the adjusted basis (for determining loss upon sale or exchange) of the stock in such other corporation or corporations disposed of by the taxpayer prior to such day and after the beginning of the taxpayer's first excess profits tax taxable year.

(2) The second rule provides that the amount of such increase shall equal the excess of the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in all domestic corporations and of obligations described in section 22 (b) (4), held by the taxpayer at the beginning of such day, over the aggregate of the adjusted basis (for determining loss upon sale or exchange) of stock in all domestic corporations and of obligations described in section (22) (b)

(4), held by the taxpayer at the beginning of its first excess profits tax taxable year.

In applying these rules, if any stock or obligations referred to therein were disposed of prior to the day for which the computation is being made, the basis shall be determined under the law applicable to the year in which disposed of.

The excluded capital of the taxpayer for the day for which the computation is being made shall be reduced by the amount by which the taxpayer's daily capital reduction for such day is increased by the application of such rules.

For definition of the term "controlled group," as here used, see section 713 (g) (5).

The effect of section 713 (g) (5) is illustrated by the following example:

Example. Corporation A and Corporation B compute their income taxes on the calendar year basis. Corporation B has 10,000 shares of capital stock outstanding. Corporation A engages in the following transactions with respect to the following items:

With respect to stock of B Corporation:

January 1, 1932, acquired 1,000 shares (10 percent) with a basis of $10,000.

September 30, 1941, acquired 4,500 shares (45 percent) with a basis of $45,000.

August 31, 1942, sold 1,000 shares (10 percent) with a basis of $10,000.

With respect to bonds of State of X:

January 1, 1939, acquired bonds with a basis of $40,000.

March 31, 1941, acquired bonds with a basis of $50,000.

April 30, 1942, sold bonds with a basis of $75,000.

With respect to capital additions:

June 30, 1941, capital stock issued (to others than B) for $75,000 cash.

The daily capital additions and reductions of A for 1942 are as follows:

CAPITAL ADDITIONS FOR 1942

(1) For each day in period—	(2) Cumulative addition to capital	(3) Increase in excluded capital since Dec. 31, 1939	(4) Capital addition (col. (2) minus col. (3), but not less than zero)
(i) Jan. 1–Apr. 30	[a] $75,000	[b] $50,000	$25,000
(ii) [1] May 1–Aug. 31	[a] 75,000	[c] 0	75,000
(iii) [2] Sept. 1–Dec. 31	[a] 75,000	10,000	65,000

[1] Excluded capital May 1, 1942 ($15,000 bonds of X plus $55,000 stock of B) $70,000
Excluded capital Jan. 1, 1940 ($40,000 bonds of X plus $10,000 stock of B) 50,000
Increase in excluded capital as of May 1, 1942 20,000

[2] Excluded capital Sept. 1, 1942 ($15,000 bonds of X plus $45,000 stock of B) 60,000
Excluded capital Jan. 1, 1940 ($40,000 bonds of X plus $10,000 stock of B) 50,000
Increase in excluded capital as of Sept. 1, 1942 10,000

[a] Stock issued.
[b] $95,000 minus $45,000 capital reduction in (iv).
[c] $20,000 minus $20,000 capital reduction in (v).

CAPITAL REDUCTIONS FOR 1942

(1) For each day in period—	(2) Basis of stock in B held	(3) Lesser of basis of stock in B acquired since Dec. 31, 1939, or of increase in excluded capital since Dec. 31, 1939	(4) Capital reduction (amount in col. (3) if col. (2) is more than 50 percent)
(iv) Jan. 1–Apr. 30	[a] $55,000	[b] $45,000	$45,000
(v) [1] May 1–Aug. 31	[a] 55,000	[c] 20,000	20,000
(vi) Sept. 1–Dec. 31	[d] 45,000	----------	0

[1] Excluded capital May 1, 1942 ($15,000 bonds of X plus $55,000 stock of B) $70,000
Excluded capital Jan. 1, 1940 ($40,000 bonds of X plus $10,000 stock of B) 50,000
Increase in excluded capital as of May 1, 1942 20,000

[a] 55 percent.
[b] Stock in B.
[c] Excluded capital.
[d] 45 percent.

SEC. 714. EXCESS PROFITS CREDIT; BASED ON INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 201(b), Rev. Act 1941, and by sec. 217, Rev. Act 1942.]

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715, is:	The credit shall be:
Not over $5,000,000	8% of the invested capital.
Over $5,000,000, but not over $10,000,000	$400,000, plus 7% of the excess over $5,000,000.
Over $10,000,000, but not over $200,000,000	$750,000, plus 6% of the excess over $10,000,000.
Over $2,000,000,000	$12,150,000, plus 5% of the excess over $200,000,000.

§ 35.714–1 *Excess profits credit based on invested capital.* Section 714 applies only to a corporation which under section 712 is entitled or is required to compute its excess profits credit under the invested capital method. Regardless of the ratio of earnings to invested capital for previous taxable years, such credit is an amount equal to 8 per cent of the corporation's invested capital for the taxable year, except that if such invested capital for any taxable year exceeds $5,000,000, the credit for such taxable year is an amount determined in accordance with the table set forth in section 714. For computation of excess profits net income if excess profits credit based on invested capital is used, see section 711 (a) (2).

SEC. 715. DEFINITION OF INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940.]

For the purposes of this subchapter the invested capital for any taxable year shall be the average invested capital for such year, determined under section 716, reduced by an amount computed under section 720 (relating to inadmissible assets). If the Commissioner finds that in any case the determination of invested capital, on a basis other than a daily basis, will produce an invested capital differing by not more than $1,000 from an invested capital determined on a daily basis, he may, under regulations prescribed by him with the approval of the Secretary, provide for such determination on such other basis. (For computation of invested capital in case of foreign corporations and corporations entitled to the benefits of section 251, see section 724.)

§ 35.715–1 *Determination of invested capital.* It is necessary for a taxpayer using the invested capital method in computing the excess profits credit to determine the invested capital for the taxable year. This is not the invested capital at the beginning of the taxable year but the average invested capital for the taxable year, reduced by an amount computed under section 720 if the taxpayer owned any inadmissible assets during the taxable year. The average invested capital for the taxable year is the aggregate of the daily invested capital for each day of the taxable year, whether such daily invested capital be a positive amount or a negative amount, divided by the number of days in such taxable year. In no event shall the average invested capital, or the invested capital, be an amount which is less than zero. The invested capital shall be computed in all cases on a daily basis.

The daily invested capital is the sum of the equity invested capital, as determined under section 718 (whether such equity invested capital be a positive amount or a negative amount), and the borrowed invested capital, as determined under section 719. The daily invested capital of a transferee upon an exchange, as defined in section 760 (a), for any day after such exchange shall be reduced by the amount of any excess computed under the provisions of section 760 (c). If the amount of the equity invested capital determined under section 718 is a negative amount and is not offset by borrowed invested capital, or if the amount of the reduction under section 760 (c) in daily invested capital is larger than the amount of such daily invested capital computed without regard to such reduction, the daily invested capital will be a negative amount.

If, during the taxable year, a corporation is not involved in a tax-free liquidation and neither receives new capital, whether paid in or borrowed, nor makes any distribution other than out of earnings and profits of the taxable year, nor retires indebtedness of the character includible in borrowed capital, its average invested capital for the taxable year is an amount equal to its daily invested capital for the first day of the taxable year.

In cases where the changes in invested capital are not numerous during the taxable year, the determination of the average invested capital may generally be simplified by taking the invested capital as of the first day of the taxable year and adding thereto such portion of each addition made during the year as the number of days remaining in the taxable year after such addition bears to the total number of days in the taxable year, and subtracting such portion of each reduction of capital as the number of days after such reduction bears to the total number of days in the taxable year. A simple method for determining average invested capital is illustrated by the following example:

Example. The invested capital of the X Corporation, which files its income tax returns on the calendar year basis, is $500,000 on January 1, 1944. The only changes in invested capital during the taxable year 1944 ar as follows:

(a) On April 1, 1944, money amounting to $100,000 is paid in for stock.

(b) On October 1, 1944, a capital distribution is made amounting to $200,000.

Aggregate invested capital from January 1 to April 1, inclusive (92 days), $500,000 × 92	$46,000,000.00
Aggregate invested capital from April 2 to October 1, inclusive (183 days) ($500,000 plus $100,000) × 183	109,800,000.00
Aggregate invested capital from October 2 to December 31, inclusive (91 days) ($600,000 minus $200,000) × 91	36,400,000.00
Aggregate invested capital for 1944	192,200,000.00
Average invested capital for 1944 ($192,200,000 divided by 366, number of days in taxable year)	525,136.61

SEC. 716. AVERAGE INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940.]

The average invested capital for any taxable year shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in such taxable year.

SEC. 717. DAILY INVESTED CAPITAL. [Added by sec. 201. Second Rev. Act 1940.]

The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day determined under section 719.

SEC. 718. EQUITY INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940; amended by secs. 202 (f) and 203, Rev. Act 1941, and by secs. 205 (d), 218, 219, and 230 (b) and (c), Rev. Act 1942.]

(a) *Definition.* The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money paid in.* Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) *Property paid in.* Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115 (l) for determtining earnings and profits;

(3) *Distribution in stock.* Distributions in stock—

(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits other than earnings and profits of such taxable year;

(4) *Earnings and profits at beginning of year.* The accumulated earnings and profits as of the beginning of such taxable year;

(5) [Not applicable to taxable years under these regulations (section 230 (c) and (d), Rev. Act 1942).]

(6) *New capital.* An amount equal to 25 per centum of the new capital for such day. The term "new capital" for any day means so much of the amounts of money or property includible for such day under paragraphs (1) and (2) as was previously paid in during a taxable year beginning after December 31, 1940, and so much of the distributions in stock includible for such day under paragraph (3) as was previously made during a taxable year beginning after December 31, 1940, subject to the following limitations:

(A) There shall not be included money or property paid in by a corporation in an exchange to which section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5) is applicable (or would be applicable except for section 371 (g)), or would have been applicable if the term "control" had been defined in section 112 (h) to mean the ownership of stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote or more than 50 per centum of the total value of shares of all classes of stock.

(B) There shall not be included money or property paid in to the taxpayer by a transferror corporation if immediately after such transaction the transferor and the taxpayer are members of the same controlled group. As used in this subparagraph and subparagraph (C), a controlled group means one or more chains of corporations connected through stock ownership with a common parent corporation if (i) more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock, of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations, and (ii) the common parent corporation owns directly more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of the classes of stock, of at least one of the other corporations

(C) There shall not be included a distribution in stock described in paragraph (3) made to another corporation, if immediately after the distribution the taxpayer and the distributee are members of the same controlled group.

(D) *Increase in inadmissible assets.* The new capital for any day of the taxable year, computed without the application of subparagraph (E), shall be reduced by the excess, if any, of the amount computed under section 720 (b) with respect to inadmissible assets held on such day, over the amount computed under section 720 (b) with respect to inadmissible assets held on the first day of the taxpayer's first taxable year beginning after December 31, 1940. For the purposes of this subparagraph, in determining whether obligations which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income are to be treated as admissible or inadmissible assets, such obligations shall be treated in the same manner as they are treated for the taxable year for which tax under this subchapter is being computed.

(E) *Maximum new capital allowable.* The new capital for any day of the taxable year shall not be more than the amount, if any, by which—

(i) the sum of the equity invested capital (computed without regard to this paragraph) and the borrowed capital (as defined in section 719 (a)) of the taxpayer as of such day, reduced by the amount of money or property paid in which is excluded by reason of the limitation of subparagraph (A) or (B) of this paragraph, exceeds

(ii) the sum of such equity invested capital and borrowed capital as of the beginning of the first day of such taxpayer's first taxable year beginning after December 31, 1940, reduced by the amount, if any, by which the accumulated earnings and profits as of such first day of such first taxable year exceed the accumulated earnings and profits (computed without regard to distributions made in taxable years beginning after December 31, 1940) as of the beginning of the first day of the taxable year for which the tax under this subchapter is being computed.

(F) *Reduction on account of distributions out of pre-1941 accumulated earnings and profits.* The new capital for any day of the taxable year, computed without the application of subparagraph (E), shall be reduced by the amount which, after the beginning of the first taxable year which begins after December 31, 1940, has been distributed out of earnings and profits accumulated prior to the beginning of such first taxable year.

(7) *Deficit in earnings and profits of another corporation.* In the case of a transferee, as defined in subsection (c) (5), an amount, determined under such paragraph, equal to the portion of the deficit in earnings and profits of a transferor attributable to property received previously to such day.

(b) *Reduction in equity invested capital.* The amount by which the equity invested capital for any day shall be reduced as provided in subsection (a) shall be the sum of the following amounts—

(1) *Distributions in previous years.* Distributions made prior to such taxable year which were not out of accumulated earnings and profits;

(2) *Distributions during the year.* Distributions previously made during such taxable year which are not out of the earnings and profits of such taxable year;

(3) *Earnings and profits of another corporation.* The earnings and profits of another corporation which previously at any time were included in accumulated earnings and profits by reason of a transaction described in section 112 (b) to (e), both inclusive, or in the corresponding provision of a prior revenue law, or by reason of the transfer by such other corporation to the taxpayer of property the basis of which in the hands of the taxpayer is or was determined with reference to its basis in the hands of such other corporation, or would have been so determined if the property had been other than money; and

(4) [Not applicable to taxable years under these regulations (section 230 (c) and (d), Rev. Act 1942).]

(5) *Deficit in earnings and profits transferred to another corporation.* In the case of a transferor, as defined in subsection (c) (5), an amount, determined under such

paragraph, equal to the portion of the deficit in earnings and profits of the transferor attributable to property transferred previously to such day.

(c) *Rules for application of subsections (a) and (b).* For the purposes of subsections (a) and (b)—

(1) *Distributions to shareholders.* The term "distribution" means a distribution by a corporation to its shareholders, and the term "distribution in stock" means a distribution by a corporation in its stock or rights to acquire its stock. To the extent that a distribution in stock is not considered a distribution of earnings and profits it shall not be considered a distribution. A distribution in stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital.

(2) *Distributions in first sixty days of taxable year.* In the application of such subsections to any taxable year beginning after December 31, 1940, so much of the distributions (taken in the order of time) made during the first sixty days thereof as does not exceed the accumulated earnings and profits as of the beginning thereof (computed without regard to this paragraph) shall be considered to have been made on the last day of the preceding taxable year.

(3) *Computation of earnings and profits of taxable year.* For the purposes of subsections (a) (3) (B) and (b) (2) in determining whether a distribution is out of the earnings and profits of any taxable year, such earnings and profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the tax under this subchapter or chapter 1 for such year and the determination shall be made without regard to the amount of earnings and profits at the time the distribution was made.

(4) [Not applicable to taxable years under these regulations (section 230 (c) and (d), Rev. Act 1942).]

(5) *Deficit in earnings and profits—earnings and profits of transferor and transferee.* If a corporation (hereinafter called "transferor") transfers substantially all its property to another corporation formed to acquire such property (hereinafter called "transferee"), if—

(A) the sole consideration for the transfer of such property is the transfer to the transferor or its shareholders of all the stock of all classes (except qualifying shares) of the transferee. (In determining whether the transfer is solely for stock, the assumption by the transferee of a liability of the transferor or the fact that the property acquired is subject to a liability shall be disregarded);

(B) the basis of the property, in the hands of the transferee, for the purposes of this subsection, is determined by reference to the basis of the property in the hands of the transferor;

(C) the transferor is forthwith completely liquidated in pursuance of the plan under which the acquisition of the property is made; and

(D) immediately after the liquidation the shareholders of the transferor own all such stock;

for the purposes of this subchapter, in computing the equity invested capital for any day after the date of the acquisition of the property, the earnings and profits or deficit in earnings and profits of the transferee and the transferor shall be computed as if, immediately before the beginning of the taxable year in which such transfer occurs, the transferee had been in existence and sustained a recognized loss, and the transferor had realized a recognized gain, equal to the portion of the deficit in earnings and profits of the transferor attributable to such property.

(d) For special rules affecting computation of property paid in for stock in connection with certain exchanges and liquidations, see Supplement C.

(e) For determination of equity invested capital in special cases, see section 723.

(f) The reserves of an insurance company shall not be included in computing equity invested capital under this section but shall be treated as borrowed capital as provided in section 719.

§ 35.718–1 *Determination of daily equity invested capital; money and property paid in.* The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in surplus, or as a contribution to capital. The terms "money paid in" and "property paid in" do not include amounts received as premiums by an insurance company subject to taxation under section 204. For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale of exchange under the law applicable to the taxable year for which the invested capital is being computed. If the property was disposed of after February 28, 1913, and before such taxable year, such unadjusted basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913; if the property was disposed of before March 1, 1913, its unadjusted basis shall be considered to be its fair market value at the time paid in.

If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. If the stock had no established market value at the time of the exchange, the fair market value of the assets of the company at that time should be determined and the liabilities deducted. The resulting net worth will be deemed to represent the total value of the outstanding stock. In determining net worth for the purpose of fixing the fair market value of the stock at the time of the exchange, the property paid in for such stock shall be included in the assets at its fair market value at that time.

If stock having no established market value is issued for intangible property, and it is necessary to determine the fair market value of such property, the following factors, among others, may be taken into consideration in determining such value: (a) The earnings attributable to such intangible assets while in the hands of the predecessor owner; and (b) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock should file with its return a full statement of the facts relating to such valuation.

If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See section 113 (a) (8).) If so acquired prior to January 1, 1921, the basis is the fair market value of the property at the time it was paid in. Where the basis is the transferor's basis, those adjustments shall be made to such basis with respect to the period before the property was paid in as are proper under section 115 (l) for determining earnings and profits. Thus, if A paid into a corporation in 1930 as paid-in surplus certain improved real estate purchased by him in 1920 for $20,000, with respect to which depreciation was allowed for the period held by him in amounts aggregating $6,000 (the full amount allowable), A's basis of $20,000 shall be reduced by $6,000 for the purpose of computing the invested capital of the corporation.

The fact that the money or property paid in has been lost, destroyed, or otherwise disposed of shall not reduce the invested capital, except as such facts are reflected in the earnings and profits as of the beginning of the taxable year. As to cases with respect to which the equity invested capital at the beginning of the year can not be determined, see section 723. As to determination of amount of property paid in for stock in connection with certain exchanges, see section 760 (b). As to determination of additional amount to be included in daily equity invested capital on account of new capital, see § 35.718–4.

See section 761 for rules for the elimination of duplication in invested capital as between two or more corporations.

§ 35.718–2 *Determination of daily equity invested capital; accumulated earnings and profits*—(a) *In general.* The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and § 35.718–5 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. As to determination of additional amount to be included in daily equity invested capital on account of new capital, see § 35.718–4. In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall subtract the income and excess profits taxes for the preceding taxable year. If there is a deficit in the accumulated earnings and profits as of the beginning of the taxable year, such deficit shall not be taken into account in determining invested capital, and in such cases the earnings and profits as of the beginning of the taxable year shall be considered as zero, but subsequent earnings and profits shall be applied against such deficit. Unrealized appreciation in value of property is not a factor in determining earnings and profits.

If the earnings and profits of another corporation have been included in the earnings and profits of the taxpayer by virtue of a transaction of the character referred to in section 718 (b) (3), for the

purpose of computing the equity invested capital of the taxpayer for each day after the day of such transaction there shall be included in the accumulated earnings and profits of the taxpayer as of the beginning of its taxable year in which such transaction occurred the proportionate part of any earnings and profits of the other corporation accumulated prior to the beginning of such taxable year and properly allocable to the taxpayer; and there shall be included in the current earnings and profits of the taxpayer for such taxable year the proportionate part of any earnings and profits of such other corporation accumulated after the beginning of such taxable year and properly allocable to the taxpayer. The amount so included in the earnings and profits of the taxpayer as of the beginning of its taxable year in which the transaction occurred or in its current earnings and profits for such year shall not exceed such proportionate part of the earnings and profits of such other corporation accumulated as of the day on which such transaction occurred.

If the transaction which resulted in the transfer to the taxpayer of the earnings and profits of another corporation constitutes an intercorporate liquidation subject to the provisions of section 761, the rule of the preceding paragraph shall apply only with respect to that portion of such earnings and profits attributable to the stock of such other corporation held by the taxpayer with a basis determined under section 761 to be a basis other than cost. Section 761 (d) (1) provides for the adjustment appropriate with respect to the earnings and profits of such other corporation taken over in the liquidation attributable to the stock of such other corporation held by the taxpayer with a basis determined to be a cost basis.

(b) *Current earnings and profits.* Earnings and profits of any taxable year can not be included in the computation of invested capital for that year. If a dividend is declared and paid during any year out of the earnings and profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital for that year unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

In any case in which the earnings and profits of another corporation are included in the accumulated earnings and profits of the taxpayer by reason of a transaction of the character referred to in section 718 (b) (3), the proportionate part of any such earnings and profits accumulated after the beginning of the taxable year of the taxpayer in which such transaction occurred and allocable to the taxpayer, but in an amount not to exceed the proportionate part of the earnings and profits of such other corporation accumulated as of the day of such transaction, shall be considered to be current earnings of the taxpayer for such taxable year.

The earnings and profits for the taxable year in which an intercorporate liquidation has occurred subject to the provisions of section 761 shall be increased or decreased, as the case may be, by the plus adjustment or the minus adjustment computed under section 761 (b) with respect to the stock of the liquidated corporation held by the taxpayer with a basis determined under section 761 to be a cost basis. See section 761 (d) (1).

§ 35.718–3 *Determination of daily equity invested capital; distributions in stock.* A distribution made prior to the taxable year by a corporation in its stock, or in rights to acquire its stock, to the extent to which it constitutes a distribution of earnings and profits of the corporation, constitutes an item of invested capital. Such a distribution made during the taxable year out of earnings and profits other than out of the earnings and profits of that year is also an item of invested capital. If a stock dividend is paid out of capital and not out of earnings and profits, or is of such a character as not to be subject to tax in the hands of a distributee because exempt as a stock dividend either by statute or otherwise, it is not deemed to constitute a distribution and does not reduce the earnings and profits account. See section 115 (h). For new capital treatment of distributions in stock, see § 35.718–4.

§ 35.718–4 *Determination of daily equity invested capital; new capital.*— (a) *In general.* The equity invested capital for any day of the taxable year, as partially determined under section 718 (a) (1) to (4), shall be increased by an amount equal to 25 percent of the new capital, if any, for such day. The term "new capital" for any such day means the aggregate amount of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, and the amount of distributions made in stock and includible for such day under section 718 (a) (1) to (3), subject, however, to the limitations provided in subparagraphs (A) to (F) of section 718 (a) (6).

(b) *Limitations under subparagraph (A) of section 718 (a) (6).* The limitations provided in subparagraph (A) of section 718 (a) (6) exclude from the term "new capital" the amount of any equity invested capital acquired in an exchange occurring during a taxable year beginning after December 31, 1940, to which section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5), is applicable. However, in determining whether an exchange is within section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5), the control requirement is considered to mean the ownership of stock possessing more than 50 per cent of the total combined voting power of all classes of stock entitled to vote or more than 50 per cent of the total value of shares of all classes of stock. These limitations also apply to all exchanges under Supplement R of Chapter 1 which would be subject to the statutory provisions referred to in the preceding sentence if it were not for section 371 (g). The application of these limitations may be illustrated by the following example:

Example. The A Corporation issues stock during the taxable year beginning on January 1, 1942, to the B Corporation in exchange for the transfer of certain property by the B Corporation. Immediately after the transfer the stock acquired by the B Corporation has a value of $10,000, the total value of all classes of stock of the A Corporation then outstanding amounting to $18,000. The A Corporation obtains no new capital, since the property for which the new stock was issued was obtained in an exchange to which section 112 (b) (5) would be applicable if the term "control" had been defined in section 112 (h) so as to include either the ownership of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of all classes of stock outstanding.

(c) *Limitations under subparagraph (B) of section 718 (a) (6).* The limitations provided in subparagraph (B) of section 718 (a) (6) exclude from the term "new capital" any money or property paid in to the taxpayer by a transferor corporation if immediately after such transaction the transferor and the taxpayer are members of the same controlled group as that term is defined in such subparagraph. The application of these limitations may be illustrated by the following example:

Example. The A Corporation owns stock in the B Corporation, and the B Corporation owns stock in the C Corporation. The A Corporation transfers property to the C Corporation in exchange for stock of the C Corporation. Immediately after the transfer the stock owned by the A Corporation in the B Corporation possesses more than 50 per cent of the total combined voting power of all classes of stock entitled to vote. Also immediately after such transfer the stock owned by the B Corporation in the C Corporation has a value equal to more than 50 percent of the total value of all classes of stock of the C Corporation. The C Corporation obtains no new capital through the acquisition of the property from the A Corporation in exchange for its stock, since immediately after the transfer the A Corporation, the transferor, and the C Corporation, the transferee, are members of the same controlled group.

(d) *Limitations under subparagraph (C) of section 718 (a) (6).* The limitations provided in subparagraph (C) of section 718 (a) (6) exclude from the term "new capital" any distribution in stock described in section 718 (a) (3) made by the taxpayer to another corporation if immediately after the distribution the taxpayer and the other corporation are members of the same controlled group as that term is defined in subparagraph (B) of section 718 (a) (6). The application of these limitations may be illustrated by the following example:

Example. The A Corporation makes a distribution in taxable stock dividends to the B and C Corporations during the taxable year beginning on January 1, 1942. Immediately after the distribution the B and C Corporations own stock in the A Corporation which has a voting power of more than 50 per cent of the combined voting power of all classes of stock entitled to vote. Also immediately after the transfer the B Corporation owns stock in the C Corporation which has a value

of more than 50 per cent of the total value of all classes of stock of the C Corporation. The taxable stock dividend distributed by the A Corporation does not constitute new capital to the A Corporation.

(e) *Limitations under subparagraph (D) of section 718 (a) (6).* The limitations provided in subparagraph (D) of section 718 (a) (6) require that the amount of new capital for any day of the taxable year, computed without the application of section 718 (a) (6) (E), shall be reduced by the excess of the amount of inadmissible assets held on the beginning of that day over the amount of such assets held on the beginning of the first day of the taxpayer's first taxable year beginning after December 31, 1940. The application of these limitations may be illustrated by the following example:

Example. The X Corporation makes its excess profits tax return on the calendar year basis. On July 1, 1942, cash in the amount of $100,000 is paid in for stock. There are no other changes made in either the amount of equity invested capital or the amount of borrowed capital at any time during the year 1942. The adjusted basis of inadmissible assets as of January 1, 1941, amounts to $5,000. The adjusted basis of such assets as of July 2, 1942, is $15,000. Under subparagraph (D) the new capital of $100,000 is reduced to $90,000 as of July 2, 1942, as shown by the following computation:

Money paid in for stock July 1, 1942	$100,000
Less:	
Excess of inadmissible assets as of July 2, 1942, over such assets as of January 1, 1941 ($15,000 minus $5,000)	10,000
New capital as reduced under subparagraph (D)	90,000

(f) *Limitations under subparagraph (E) of section 718 (a) (6).* The limitations provided in subparagraph (E) of section 718 (a) (6) prevent new capital as of any day from exceeding the amount by which the total equity invested capital and borrowed capital as of such day (computed without including the 25 per cent increase and reduced as provided in such subparagraph on account of amounts excluded under subparagraph (A) or (B) exceeds the sum of the equity invested capital and borrowed capital as of the first day of the taxpayer's first taxable year beginning after December 31, 1940 (reduced as provided in such subparagraph on account of reduction in accumulated earnings and profits other than as the result of distributions). The application of these limitations may be illustrated by the following example:

Example. The Y Corporation makes its return on the calendar year basis. Its equity invested capital as of January 1, 1941, amounts to $30,000, consisting of money paid in for stock, $20,000, and accumulated earnings and profits, $10,000. Its borrowed capital as of January 1, 1941, consists of bonds outstanding in the amount of $15,000. Accordingly, the total of its equity invested capital and borrowed capital as of January 1, 1941, is $45,000. The corporation has no inadmissible assets at any time during the year 1941 or 1942. No changes in its equity invested capital or borrowed capital occur in 1941. On July 1, 1942, the following events occur:

(1) The corporation distributes taxable stock dividends amounting to $5,000 out of earnings and profits accumulated prior to January 1, 1941;

(2) Money amounting to $15,000 is paid in as a contribution to capital;

(3) Property with an unadjusted basis of $20,000 for determining loss is acquired for stock in an exchange to which section 112 (b) (4) is applicable; and

(4) Bonds in the amount of $10,000 are retired.

Only $5,000 of the $40,000 of new capital (tentative) arising out of the transactions which took place on July 1, 1942, constitutes new capital as of July 2, 1942, computed as follows:

(1) Sum of equity invested capital and borrowed capital as of July 2, 1942 (computed without regard to 25 percent increase in new capital)	$70,000
(2) Property paid in for stock excluded under subparagraph (A)	20,000
(3) Item (1) minus item (2)	50,000
(4) Sum of equity invested capital and borrowed capital as of January 1, 1941	45,000
(5) New capital as of July 2, 1942 (item (3) minus item (4))	5,000

If the accumulated earnings and profits of the Y Corporation are reduced to zero as of January 1, 1943, because of the stock dividend distribution of $5,000 made on July 1, 1942, and because of an operating loss of $5,000 during the taxable year 1942, the new capital includible in equity invested capital as of January 1, 1943, would remain at $5,000 under the application of subparagraph (E), as shown by the following computation:

(1) Sum of equity invested capital and borrowed capital as of January 1, 1943 (computed without regard to 25 percent increase in new capital)	$65,000
(2) Property paid in for stock excluded under subparagraph (A)	20,000
(3) Item (1) minus item (2)	45,000
(4) Sum of equity invested capital and borrowed capital as of January 1, 1941	45,000
(5) Excess of accumulated earnings and profits as of January 1, 1941, over earnings and profits, computed without regard to distributions, as of January 1, 1943 ($10,000 minus $5,000)	5,000
(6) Item (4) reduced by item (5)	40,000
(7) New capital as of January 1, 1942 (item (3) minus item (6))	[1] 5,000

[1] The application of subparagraph (F) is not shown in the above computation since it does not change the result.

(g) *Limitations under subparagraph (F) of section 718 (a) (6).* The limitations provided in subparagraph (F) of section 718 (a) (6) require that new capital for any day of the taxable year (computed without the application of subparagraph (E)), shall be reduced by distributions made after the beginning of the first taxable year which begins after December 31, 1940, out of earnings and profits accumulated prior to the beginning of such first taxable year. The application of these limitations may be illustrated by the following examples:

Example (1). The Z Corporation makes its return on the calendar year basis. Its total equity invested capital and borrowed capital as of January 1, 1941, is $100,000, including $10,000 of accumulated earnings and profits. No changes occur in its equity invested capital or borrowed capital during 1941. The only capital acquired during 1942 amounts to $10,000, resulting from the distribution of a taxable stock dividend on July 1, 1942. The corporation has no earnings and profits for 1942. The capital resulting from the stock dividend is excluded from new capital by subparagraph (F) (as well as by subparagraph (E)), for it is reduced by the amount distributed out of earnings and profits accumulated prior to January 1, 1941.

Example (2). Assume that the facts with respect to the Z Corporation are the same as in example (1), except that the Z Corporation has an operating loss of $10,000 for the year 1942. Although under subparagraph (E), because of the adjustment relative to a reduction in accumulated earnings and profits not resulting from distributions, there would be new capital as of January 1, 1942, in the amount of $10,000, the application of subparagraph (F) prevents the stock dividend distributed on July 1, 1942, from being new capital, inasmuch as the capital from the stock dividend ($10,000) must be reduced by the amount of the distribution out of earnings and profits accumulated prior to January 1, 1941 ($10,000).

Example (3). Assume that the facts with respect to the Z Corporation are the same as in example (1), except that there are no earnings and profits in 1942 and no operating loss for such year and that its earnings and profits for 1943 are $10,000. Although, because of the 1943 earnings and profits, there would be new capital under subparagraph (E) in the amount of $10,000 as of January 1, 1944, subparagraph (F) prevents the stock dividend distributed on July 1, 1942, from being new capital, inasmuch as the capital resulting from such stock dividend ($10,000) is reduced by the amount of the distribution ($10,000) made out of earnings and profits accumulated prior to January 1, 1941.

§ 35.718–5 *Determination of daily equity invested capital; reductions by distributions.* The amount of the daily equity invested capital as partially determined by taking the aggregate of the sums described in section 718 (a) shall be reduced by the amount of the distributions made in prior taxable years which were not out of accumulated earnings and profits plus the amount of the distributions previously made during the taxable year which were not out of the earnings or profits of such year. In determining whether a distribution is out of the earnings and profits of any taxable year, such earnings and profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the excess profits tax imposed by the Excess Profits Tax Act of 1940, or by reason of the tax imposed by Chapter 1, and without regard to the amount of earnings and profits at the time the distribution was made.

For example, if a corporation making a return on the calendar year basis had accumulated earnings and profits as of the beginning of the taxable year of $50,000, and earnings and profits during the taxable year (without diminution by any distributions, the excess profits tax for the taxable year, or the income tax for the taxable year) of $150,000, all earned during the last six months of the taxable year, and distributed $175,000

as dividends during the taxable year, $56,000 on April 1, $70,000 on July 1, and $49,000 on October 1, six-sevenths of each distribution will be deemed to have been paid out of earnings of the taxable year and one-seventh from accumulated earnings and profits, so that accumulated earnings and profits will be reduced by $8,000 beginning April 2, by an additional $10,000 beginning July 2, and by an additional $7,000 beginning October 2.

In computing accumulated earnings and profits as of the beginning of the taxable year and in determining what distributions during the taxable year are made out of the earnings and profits of such year, for the purposes of section 718 (a) and (b) distributions made during the first 60 days of any taxable year are deemed, to the extent they do not exceed the accumulated earnings and profits as of the beginning of the taxable year, to have been made on the last day of the preceding taxable year. In applying such rule, such distributions shall be considered in the order of time. For example, if a corporation on the calendar year basis has accumulated earnings or profits of $100,000 on January 1, 1942, and makes distributions of $75,000 on January 15, 1942, and $50,000 on February 15, 1942, the distribution of January 15, 1942, and $25,000 of the distribution of February 15, 1942, are considered as having been made on December 31, 1941.

A distribution is considered to be made on the date it is payable, except that where no date is set for its payment, the distribution is considered to be made on the date when it is declared, and except that distributions payable during the first 60 days of a taxable year are considered to be distributions made on the last day of the preceding taxable year to the extent such distributions do not exceed the accumulated earnings and profits as of the beginning of the taxable year.

The purchase by a corporation of its own stock for investment does not of itself result in a reduction of invested capital. But see § 35.720–1 relative to inadmissible assets. If, however, the corporation subsequently cancels such stock, invested capital is reduced, beginning with the day following such cancellation, by so much of the adjusted basis of such stock in the hands of the corporation as is not properly chargeable to earnings and profits of the taxable year. If stock is purchased for retirement, there is a distribution on the date of purchase of the amount paid therefor and the invested capital is reduced by the amount thereof not properly chargeable to earnings and profits of the taxable year.

The amount of distributions by a corporation whether in bonds of such corporation, or in money or other property may exceed the amount of the equity invested capital computed without regard to such distributions. In such event, the equity invested capital of such corporation shall be reduced by virtue of such distributions to a negative amount.

§ 35.718–6 *Determination of daily equity invested capital; reduction by earnings and profits of another corporation.* Section 718 (b) (3) provides for the elimination of the duplication which occurs in the computation of the equity invested capital of the taxpayer following a transaction of the character referred to therein, as a result of which the earnings and profits of another corporation became the earnings and profits of the taxpayer.[1] The earnings and profits of such other corporation having been included at the time of the transaction in the earnings and profits of the taxpayer, they remain continuously thereafter a part of such earnings and profits account for the purpose of computing for any day after such transaction the earnings and profits, the accumulated earnings and profits at the beginning of the taxable year, and the earnings and profits of the taxable year. In addition, however, the amount of such included earnings and profits is also brought into computation of equity invested capital of the taxpayer under provisions of section 718 other than section 718 (a) (4) relating to accumulated earnings and profits as of the beginning of the taxable year. Thus, if the transaction is a reorganization to which section 113 (a) (7) is applicable, and in which the taxpayer receives all the assets of another corporation in exchange solely for its own stock, such amount has already been taken into account in property paid in for stock under section 718 (a) (2); or if the transaction is an intercorporate liquidation of another corporation involving a distribution with respect to stock of such other corporation held by the taxpayer with a basis determined under section 761 to be a basis other than cost, such amount has already been taken into account in the computation of equity invested capital of the taxpayer, as adjusted under section 761 (d) (2).

To preclude this duplicate inclusion of the earnings and profits of another corporation in the invested capital of the taxpayer, section 718 (b) (3) provides, as a step in the computation of equity invested capital, for the reduction of equity invested capital otherwise computed by the amount of earnings and profits of another corporation previously at any time included in the earnings and profits of the taxpayer. This adjustment is to be made in the computation of equity invested capital for each day after the day of such transaction, regardless of whether the earnings and profits absorbed were produced during the taxable year of the taxpayer in which such transaction occurred or in a prior taxable year, and regardless of the condition of the earnings and profits account of the taxpayer immediately prior to or at any time subsequent to the date of such transaction.

§ 35.718–7 *Determination of daily equity invested capital; deficit in earnings and profits of transferor transferred to transferee.* The determination of the amount of money or property paid in for stock or as paid-in surplus or as a contribution to capital of the transferee on account of certain tax-free exchanges is prescribed by section 760. (The determination with respect to excess profits tax taxable years beginning prior to January 1, 1942, is also prescribed by section 760 if the taxpayer elects, pursuant to the provisions of section 230 (d) of the Revenue Act of 1942, to have the provisions of section 760 apply.) Such amount of property paid in is computed with respect to the unadjusted basis for determining loss of the property in the hands of the transferee, adjusted for the period prior to the time the property was paid in by amounts equal to the adjustments proper under section 115 (l) for determining earnings and profits, minus, *inter alia*, any liability of the transferor assumed upon the exchange or to which the property received was subject. Since the unadjusted basis of the property received minus any liabilities assumed by the transferee or to which the property received was subject, will reflect the amount of any deficit incurred by the transferor, the equity invested capital of the transferee resulting from the exchange would be reduced by the amount of such deficit, although the amount of such deficit would not have reduced the equity invested capital of the transferor, prior to the exchange, below the amount of its accumulated earnings and profits.

In certain cases where, despite a reorganization of the transferor involving a tax-free exchange of its assets, the corporate identity of the transferor is preserved, section 718 (a) (7) provides that equity invested capital of the transferee for taxable years beginning after December 31, 1939, shall be increased by that portion of the deficit in earnings and profits of the transferor attributable to the property transferred by the transferor to the transferee. Section 718 (b) (5) provides for the complementary reduction in the equity invested capital of the transferor for any day after such a transfer in taxable years beginning after December 31, 1939, by the amount of the deficit in earnings and profits attributable to the property transferred.

If the transferee has received substantially all, but not all, the property of the transferor upon the exchange, the deficit in earnings and profits of the transferor attributable to the property transferred shall be an amount which bears the same ratio to the total deficit in earnings and profits of the transferor as the excess of the basis of the property transferred to the transferee (adjusted by amounts equal to the adjustments proper under section 115 (l) for determining earnings and profits) over the amount of any liability of the transferor assumed upon the exchange and of any liability subject to which such property was so received bears to the excess of the basis of the total assets of the transferor immediately prior to the exchange (adjusted by amounts equal to the adjustments proper under section 115 (l) for determining earnings and profits) over the amount of any liability of the transferor, and the amount of any liability subject to which such assets were held immediately prior to the transfer.

The adjustments provided by section 718 (a) (7) and section 718 (b) (5) are applicable only in case a corporation

[1] *Commissioner* v. *Sansome*, 60 Fed. (2d) 931.

(called the transferor) transfers substantially all its property to another corporation formed especially to acquire such property (called the transferee), *Provided*, That:

(a) The sole consideration for the transfer of such property is the transfer to the transferor or its shareholders of all the stock of all classes (except qualifying shares) of the transferee. In determining whether the transfer is solely for stock, the assumption by the transferee of a liability of the tranferor or the fact that the property acquired was received subject to a liability shall be disregarded;

(b) The basis of the property in the hands of the transferee is determined by reference to the basis of such property in the hands of the transferor;

(c) The transferor is forthwith completely liquidated in pursuance of the plan under which the acquisition of the property was made; and

(d) Immediately after such liquidation the shareholders of the transferor own all the stock of the transferee received by the transferor.

The earnings and profits of the transferee for any day after the date of acquisition of the property shall be considered to have been reduced by an amount equal to the amount by which the equity invested capital was increased pursuant to section 718 (a) (7), as if immediately before the beginning of the taxable year in which such transfer occurred the transferee had been in existence and had sustained a recognized loss equal to the portion of the deficit in earnings and profits of the transferor attributable to the property acquired by the transferee. The deficit in earnings and profits of the transferor for any day after the date of the transfer of property, and prior to the liquidation, must be decreased by the amount by which the equity invested capital is decreased pursuant to section 718 (b) (5), as if immediately before the beginning of the taxable year in which the transfer occurred the transferor had realized a recognized gain equal to the portion of the deficit in earnings and profits of the transferor attributable to the property transferred to the transferee.

The provisions of section 718 (a) (7), section 718 (b) (5), and section 718 (c) (5) shall apply only in the case of a tax-free exchange involving a single transferor and shall not apply to instances where two or more transferors transfer property to a transferee in a tax-free exchange.

The provisions of this section may be illustrated by the following example:

Example. In 1942 Corporation A, which was organized under the laws of the State of New York, found it necessary to incorporate under the laws of Delaware. Consequently a new Corporation B was organized under the laws of Delaware, and in exchange for all its stock received the entire assets of Corporation A. Immediately after the exchange Corporation A was liquidated, and the stock of Corporation B was transferred to the shareholders of Corporation A. Immediately prior to the exchange, the equity invested capital of Corporation A, consisting of money and property previously paid in for stock, was $500,000; in addition, Corporation A had a deficit in earnings and profits of $200,000. The adjusted basis of the assets of Corporation A at the time of the exchange properly adjusted under section 115 (l) for the computation of earnings and profits, and consequently the unadjusted basis of the assets to Corporation B at such time was $300,000. The equity invested capital of Corporation B, however, as of January 1, 1943, is $500,000, since section 718 (a) (7) requires the addition of Corporation A's $200,000 deficit to the equity invested capital of Corporation B, otherwise determined. As of January 1, 1943, Corporation B is also considered to have a deficit in earnings and profits of $200,000. If in 1943 Corporation B had earned $150,000, its equity invested capital as of January 1, 1944, would be $500,000 and its deficit in earnings and profits would be $50,000 ($200,000 minus $150,000). If in 1944 Corporation B had earned $75,000, its equity invested capital as of January 1, 1945, would be $525,000 ($500,000 plus $25,000 accumulated earnings and profits ($150,000 plus $75,000, minus $200,000)). Immediately after the exchange the equity invested capital of Corporation A would be $300,000 since section 718 (b) (5) requires the reduction of Corporation A's invested capital by the amount of any deficit in earnings and profits transferred to the transferee pursuant to the provisions of section 718 (c) (5), and Corporation A's deficit in earnings and profits computed pursuant to section 718 (c) (5) would be zero ($200,000 minus $200,000).

§ 35.718–8 *Determination of daily equity invested capital; insurance companies.* Section 718 (f) provides that the reserves of certain insurance companies shall not be included in computing equity invested capital but shall be treated as borrowed capital as provided in section 719. This rule does not apply to the computation of invested capital of mutual insurance companies other than life or marine, the reserves of which would not be included in equity invested capital under section 718 (see section 718 (e)) but are included only in equity invested capital as provided in section 723 (b).

SEC. 719. BORROWED INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940; amended by secs. 205 (e) and 230 (b), Rev. Act 1942.]

(a) *Borrowed capital.* The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus,

(2) In the case of a taxpayer having a contract (made before the expiration of 30 days after the date of the enactment of the Second Revenue Act of 1940) with a foreign government to furnish articles, materials, or supplies to such foreign government, if such contract provides for advance payment and for repayment by the vendor of any part of such advance payment upon cancellation of the contract by such foreign government, the amount which would be required to be so repaid if cancellation occurred at the beginning of such day, but no amount shall be considered as borrowed capital under this paragraph which has been includible in gross income, plus,

(3) In the case of an insurance company, the mean of the amount of the pro rata unearned premiums determined at the beginning and end of the taxable year, plus,

(4) In the case of a life insurance company, the mean of the amount of the adjusted reserves, and the mean of the amount of the reserves on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time with reference to which the computation was made, life, health, or accident contingencies, determined at the beginning and end of the taxable year.

(b) *Borrowed invested capital.* The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day.

§ 35.719–1 *Borrowed invested capital.* The borrowed invested capital for any day of the taxable year is 50 percent of the borrowed capital for such day determined as of the beginning of such day. Borrowed capital is defined to mean:

(a) Outstanding indebtedness (other than interest, but including indebtedness assumed or to which the taxpayer's property is subject) of the taxpayer which is evidenced by a bond, a promissory note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus

(b) In the case of a corporation having a contract, made before November 8, 1940, with a foreign government to furnish articles, materials, or supplies to such foreign government, amounts received as advance payment in connection with and as provided by such contract, to the extent such amounts would be repayable pursuant to the terms of the contract, if cancellation by such foreign government occurred at the beginning of the day for which the borrowed capital is being ascertained, but no amount shall be included as borrowed capital which has been includible in gross income, plus

(c) In the case of an insurance company (except a mutual insurance company other than life or marine), the mean of the amount of the pro rata unearned premiums (see section 204 (b) (5) and § 29.204–2 of this chapter) determined at the beginning and end of the taxable year, plus

(d) In the case of a life insurance company, for any taxable year beginning after December 31, 1941, the mean of the amount of the adjusted reserves (see section 201 (c) (3) and § 29.201–6 of this chapter) and the mean of the amount of the reserves on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time with reference to which the computation was made, life, health, or accident contingencies, determined at the beginning and end of the taxable year.

The provisions of section 719 (a) (3) and (4) do not apply to mutual insurance companies other than life or marine. For computation of equity invested capital in the case of such corporations, see section 723 (b) and § 35.723–2.

In order for any indebtedness to be included in borrowed capital it must be bona fide. It must be one incurred for business reasons and not merely to increase the excess profits credit. If indebtednes of the taxpayer is assumed by another person it ceases to be borrowed capital of the taxpayer. For such purpose an assumption of indebtedness in-

cludes the receipt of property subject to indebtedness.

Whether outstanding certificates designated by such names as "debenture preferred stock" or "guaranteed preferred stock" constitute borrowed capital depends upon whether the holder has a proprietary interest in the corporation or has the rights of a creditor, determined in the light of all of the facts. The name borne by the certificate is of little importance. More important attributes to be considered are whether or not there is a maturity date, the source of payment of any "interest" or "dividend" specified in the certificate (whether only out of earnings or out of capital and earnings), rights to enforce payment, and other rights as compared with those of general creditors.

The term "certificate of indebtedness" includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipts of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check.

The provisions of section 719 (a) (2) relating to contracts with a foreign government may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis and reports its income on the accrual basis, entered into a contract with a foreign government on November 1, 1940, for the manufacture and delivery of certain parts for aircraft, and received thereunder an advance payment as of that date of $500,000. The contract provided for its cancellation by the vendee, and further provided that the advance payment should be returned upon such cancellation less the sum of $100,000 and $5,000 for each unit delivered before cancellation. No units were delivered during 1940 or 1941. Ten units were delivered December 1, 1942, another 10 units December 30, 1942, and the contract was canceled December 31, 1942, before any other deliveries had been made. Borrowed invested capital would be increased $200,000 (50 percent of $400,000) for each day beginning January 1, 1942, and ending December 1, 1942; $175,000 (50 percent of $350,000) for each day beginning December 2, 1942, and ending December 30, 1942; and $150,000 (50 percent of $300,000) for one day, December 31, 1942.

SEC. 720. ADMISSIBLE AND INADMISSIBLE ASSETS. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 12 (a), Excess Profits Tax Amendments 1941, and by secs. 207 (h) and 220, Rev. Act 1942.]

(a) *Definitions.* For the purposes of this subchapter—

(1) The term "inadmissible assets" means—

(A) Stock in corporations except stock in a foreign personal-holding company, and except stock which is not a capital asset; and

(B) Except as provided in subsection (d), obligations described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income.

(2) The term "admissible assets" means all assets other than inadmissible assets.

(b) *Ratio of inadmissibles to total assets.* The amount by which the average invested capital for any taxable year shall be reduced as provided in section 715 shall be an amount which is the same percentage of such average invested capital as the percentage which the total of the inadmissible assets is of the total of admissible and inadmissible assets. For such purposes, the amount attributable to each asset held at any time during such taxable year shall be determined by ascertaining the adjusted basis thereof (or, in the case of money, the amount thereof) for each day of such taxable year so held and adding such daily amounts. The determination of such daily amounts shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. The adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under section 113.

(c) *Computation if short-term capital gain.* If during the taxable year there has been a gain from the sale or exchange of a capital asset held for not more than 6 months with respect to an inadmissible asset, then so much of the amount attributable to such inadmissible asset under subsection (b) as bears the same ratio thereto as such gain bears to the sum of such gain plus the dividends and interest on such asset for such year, shall, for the purpose of determining the ratio of inadmissible assets to the total of admissible and inadmissible assets, be added to the total of admissible assets and subtracted from the total of inadmissible assets.

(d) *Treatment of Government obligations as admissible assets.* If the excess profits credit for any taxable year is computed under section 714, the taxpayer may in its return for such year elect to increase its normal tax net income for such taxable year by an amount equal to the amount of the interest on, reduced by the amount of the amortizable bond premium under section 125 attributable to, all obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income. In such case, for the purposes of this section, the term "admissible assets" includes such obligations, and the term "inadmissible assets" does not include such obligations.

§ 35.720–1 *Reduction of average invested capital for inadmissible assets.* If a taxpayer owns any "inadmissible assets" on any day during the taxable year, then section 715 relating to the computation of invested capital requires the average invested capital to be reduced in the same ratio as the inadmissible assets bear to the total assets. The term "inadmissible assets" means (1) stock in all corporations, domestic or foreign, except stock in a foreign personal holding company, and except stock which is not a capital asset (such as stock held primarily for sale to customers by a dealer in securities), and (2) all obligations described in section 22 (b) (4), any part of the interest from which is excludible from gross income or allowable as a credit against net income. Stock held in the treasury of the issuing corporation is an inadmissible asset. The term "admissible assets" means all assets other than inadmissible assets. However, if a taxpayer in its return for the taxable year elects to increase its normal-tax net income for that year for the purpose of the excess profits tax by including all the interest derived from the obligations described in section 22 (b) (4), reduced by the amount, if any, of the amortizable bond premium under section 125 attributable to such obligations (see § 29.125–1 of this chapter), all such obligations shall be considered admissible assets for such taxable year. For the purposes of the preceding sentence, (i) the term "interest" includes, in the case of obligations issued at a discount, so much of such discount as (for purposes of determining gain or loss upon sale or other disposition) is treated as interest in the hands of the taxpayer for the taxable year, and (ii) the term "obligations described in section 22 (b) (4)" includes obligations, whether or not issued at a discount, the discount on which, if issued at a discount, would be so treated. The following steps are necessary in the application of section 720:

(a) There must first be determined the adjusted basis for determining loss upon the sale or exchange, as provided in section 113, for each asset, or, in the case of money, the amount thereof, owned at the beginning of each day during the taxable year.

(b) There must then be determined the aggregate of the admissible assets and the aggregate of the inadmissible assets for the taxable year.

(c) The average invested capital for the taxable year must then be reduced by the percentage which the total of the inadmissible assets is of the total of the admissible and inadmissible assets.

If the taxpayer had a gain during the taxable year from the sale or exchange of a capital asset held for not more than six months, which capital asset was an inadmissible asset, then the amount of the admissible assets shall be increased and the amount of the inadmissible assets shall be decreased by so much of the amount attributable to such inadmissible asset as such gain bears to the sum of such gain plus the dividends or interest on such asset for such year.

The amount of admissible assets and the amount of inadmissible assets shall be determined as of the beginning of each day. If, however, it is impracticable to determine such amounts as of the beginning of each day but the amounts held on a given day of each month throughout the year or at other regular intervals not exceeding one year can be determined, the amounts held as of the beginning of each day of such month or other period may be determined by dividing by two the sum of the amounts of such assets held at the beginning of the period and the amounts held at the end of the period. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. Ordinarily the taxpayer will be able to determine the amount of inadmissible assets actually held on each day of the taxable year. The fact that it may be impracticable to determine the amount of admissible assets actually held on each day of the taxable year will not relieve the taxpayer from the necessity of determining the actual amount of inadmissible assets held unless such determination is likewise impracticable.

The adjustment for inadmissible assets may be illustrated by the following example:

Example. The average invested capital of the X Corporation, not a dealer in securities, for its taxable year 1944, determined under section 716, is $1,000,000. On January 1, 1944, the corporation holds bonds of a State which it had previously purchased for $60,000, and stock in another corporation (not a foreign personal holding company) which it had pre-

viously purchased for $25,000. On July 1, 1944, it purchases stock in another corporation (not a foreign personal holding company) for $20,000, and on July 4, 1944, additional State bonds for $48,700. On September 1, 1944, it sells for $29,000 the stock purchased on July 1, 1944, after receiving a dividend of $1,000 thereon. The aggregate of the daily amounts of the admissible and inadmissible assets for the taxable year 1944 is $400,000,000. The corporation does not elect to increase its normal-tax net income for excess profits tax purposes by the amount of the interest derived from the State bonds. None of the bonds was purchased at a premium.

The invested capital of the X Corporation as defined in section 715 is $900,000, computed as follows:

Average invested capital for 1944	$1,000,000
Less:	
Amount computed under section 720 for inadmissible assets (10 percent of $1,000,000, see Schedule I below)	100,000
Invested capital for 1944 as defined in section 715	900,000

Schedule I

(*a*) Aggregate of the daily amounts of inadmissible assets for the year 1944 before adjustment for short-term capital gain:		
(1) State bonds held January 1, 1944 ($60,000 multiplied by 366 (days))	$21,960,000	
(2) State bonds purchased July 4, 1944 ($48,700 multiplied by 180 (days))	8,766,000	
(3) Stock in domestic corporation held January 1, 1944 ($25,000 multiplied by 366 (days))	9,150,000	
(4) Stock in domestic corporation purchased July 1, 1944, for $20,000 and sold September 1, 1944, for $29,000 ($20,000 multiplied by 62 (days))	1,240,000	
		$41,116,000
(*b*) Less: Adjustment on account of short-term capital gain (see Schedule II below)		1,116,000
(*c*) Aggregate of the daily amounts of the inadmissible assets after adjustment for short-term capital gain (item (*a*) minus item (*b*))		40,000,000
(*d*) Aggregate of the daily amounts of admissible and inadmissible assets for the year 1944 (this item being unaffected by the adjustment on account of the short-term capital gain)		400,000,000
(*e*) Ratio of aggregate of daily amounts of inadmissible assets (item (*c*) above) to aggregate of daily amounts of admissible and inadmissible assets (item (*d*) above), $40,000,000 divided by $400,000,000	percent	10

Schedule II

Computation of adjustment on account of short-term capital gain:	
(*a*) Amount attributable to inadmissible assets before adjustment under section 720 (c) for short-term capital gain (stock in domestic corporation purchased July 1, 1944, for $20,000 and sold September 1, 1944, for $29,000), $20,000 multiplied by 62 (days)	$1,240,000
(*b*) Amount of gain realized ($29,000 minus $20,000)	9,000
(*c*) Sum of gain plus dividends received ($9,000 plus $1,000)	10,000
(*d*) Ratio of gain (item (*b*)) to sum of gain plus dividends received (item (*c*)), $9,000 divided by $10,000 (percent)	90
(*e*) Adjustment on account of short-term capital gain, 90 percent of $1,240,000 (item (*a*))	1,116,000

SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 5, Excess Profits Tax Amendments 1941, and by secs. 221 and 222 (f), Rev. Act 1942.]

(a) *Definitions.* For the purposes of this section—

(1) *Abnormal income.* The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) *Separate classes of income.* Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

(B) [Not applicable to taxable years under these regulations (section 222 (f), Rev. Act 1942).]

(C) Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

(E) In the case of a lessor of real property, income included in gross income for the taxable year by reason of the termination of the lease; or

(F) Income consisting of dividends on stock of foreign corporations, except foreign personal holding companies.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (F), inclusive, shall be subject to regulations prescribed by the Commissioner with the approval of the Secretary.

(3) *Net abnormal income.* The term "net abnormal income" means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year through the expenditure of which such abnormal income was in whole or part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

(b) *Amount attributable to other years.* The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

(c) *Computation of tax for current taxable year.* The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year.

(d) *Computation of tax for future taxable year.* The amount of the net abnormal income attributable to any future taxable year shall, for the purposes of this subchapter, be included in the gross income for such taxable year.

(1) The tax under this subchapter for such future taxable year shall not exceed the sum of—

(A) the tax under this subchapter for such future taxable year computed without the inclusion in gross income of the portion of such net abnormal income which is attributable to such year, and

(B) the decrease in the tax under this subchapter for the previous taxable year in which the whole of such abnormal income would, without regard to this section, be includible which resulted by reason of the computation of such tax for such previous taxable year under the provisions of subsection (c); but the amount of such decrease shall be diminished by the aggregate of the increases in the tax under this subchapter for the future taxable year as computed under subparagraph (A) and for the taxable years intervening between such previous taxable year and such future taxable year which have resulted because of the inclusion of the portions of such net abnormal income attributable to such intervening years in the gross income for such intervening years.

(2) If, in the application of subsection (c), net abnormal income from more than one taxable year is attributable to any future taxable year, paragraph (1) of this subsection shall be applied with respect to such future taxable year in the order of the taxable years from which the net abnormal income is attributable beginning with the earliest, as if the portion of the net abnormal income from each such year was the only amount so attributable to such future taxable year, and (except in the case of the portion for the earliest previous taxable year) as if the tax under this subchapter for the future taxable year was the tax determined under para-

graph (1) with respect to the portion for the next earlier previous taxable year.

(3) If in the application of paragraph (1) to any future taxable year it is determined that the decrease in tax computed under paragraph (1) (B) with respect to the net abnormal income, a portion of which is included in the gross income for the future taxable year, does not exceed the aggregate of the increases in tax computed under paragraph (1) (B) with respect to such net abnormal income, then the portions of such net abnormal income attributable to taxable years subsequent to such future taxable year shall not be included in the gross income for such subsequent taxable years. For the purpose of computing the tax under this subchapter for a taxable year subsequent to the future taxable year, the portion of net abnormal income attributable to the future taxable year shall not be included in the gross income for such future taxable year to the extent that the inclusion of such portion of net abnormal income in the gross income for such future taxable year did not result in an increase in tax for such future taxable year by reason of the provisions of paragraph (1).

(e) *Application of section.* This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. For the purposes of subsections (c) and (d)—

(1) Net abnormal income means the aggregate of the net abnormal income of all classes for one taxable year.

(2) Under regulations prescribed by the Commissioner with the approval of the Secretary, the tax under this subchapter for previous taxable years shall be computed as if the portions of net abnormal income for each previous taxable year for which the tax was computed under this section were included in the gross income for the other previous taxable years to which such portions were attributable.

(3) If both subsections (c) and (d) are applicable to any current taxable year, subsection (d) shall be applied without regard to subsection (c), and subsection (c) shall be applied as if the tax under this subchapter, except for subsection (c), was the tax computed under subsection (d) and as if the gross income and the other amounts necessary to determine the adjusted excess profits net income were those amounts which would result in the tax computed under subsection (d).

(f) *Abnormal income from exploration, etc.* If by reason of taking into account, in determining constructive average base period net income under section 722, exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months, such constructive average base period net income is higher than it would be without such taking into account, only such portion of the income in the taxable year resulting from such activity which is of a class described in subsection (a) (2) (C) as is attributable to another taxable year under this subchapter shall be deemed attributable to a year other than the taxable year.

§ 35.721–1 *Abnormalities in income in taxable year.* Section 721 provides relief where abnormal income (as defined in section 721 (a)) for any excess profits tax taxable year is attributable to other taxable years. The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any excess profits tax taxable year (1) if it is abnormal for the taxpayer to derive gross income of such class, or (2) if the taxpayer normally derives gross income of such class but the amount of such income of such class is in excess of 125 percent of the average amount of the gross income of the same class determined for the four previous taxable years or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence. It is abnormal for a taxpayer to derive income of any class only if the taxpayer had no gross income of that class for the four previous taxable years. For the purpose of determining abnormal income under this paragraph the gross income of the class for the previous taxable years is not to be increased or decreased by any allocation under the provisions of section 721. Abnormal income is to be determined by considering classes of income, and not merely particular items. As to the classification of income, see § 35.721–2.

Abnormal income must be adjusted, as provided in section 721 (a) (3), in order to determine net abnormal income. Net abnormal income must then be allocated to the various item included in abnormal income. The items of net abnormal income so determined are the amounts which may be attributed to other taxable years under these regulations. Net abnormal income and the allocated amounts which are items of net abnormal income are determined in the following manner:

(a) Net abnormal income is determined as follows:

(1) The abnormal income of each class is computed;

(2) Such abnormal income is then reduced by 125 percent of the average amount of the gross income of the same class for the four previous taxable years or, if the taxpayer was not in existence for four previous taxable years, the previous taxable years during which it was in existence;

(3) The abnormal income is further reduced by an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income for the taxable year, through the expenditure of which such abnormal income was in whole or in part derived, as the abnormal income, reduced as provided in (a) (2), bears to the abnormal income. The amount thus determined is the net abnormal income.

(b) The items of net abnormal income are determined as follows:

(1) Each item of abnormal income is reduced, but not below zero, by an amount equal to 125 percent of the average income, if any, for the four previous taxable years, arising out of the same property as the income represented by the item;

(2) Each item of abnormal income is further reduced, but not below zero, by an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income for the taxable year, through the expenditure of which such item was in whole or in part derived, as the amount of the item of abnormal income reduced in (b) (1) bears to the amount of the item of abnormal income;

(3) The aggregate of the items as reduced under (b) (1) and (2) is determined;

(4) Net abnormal income is allocated to each item in the proportion that the item, reduced as provided in (b) (1) and (2), bears to the aggregate of the items so reduced, determined in (b) (3). The amount so allocated is an item of net abnormal income.

The following examples illustrate the computation of items of net abnormal income:

Example (1) For the taxable year 1942, the A corporation, which makes its income tax returns on the calendar year basis, has gross income of $1,000,000 from judgments. This consists of two items, one of $800,000 for a judgment against X and the other of $200,000, for a judgment against Y. Its average income of this class for the four previous taxable years was $300,000. For 1942, it has direct deductible expenses of $160,000 applicable to the judgment against X. There were no direct deductible expenses applicable to the other judgment. The $1,000,000 is abnormal income, since it is in excess of 125 percent of the average income of this class for the four previous taxable years. The items of net abnormal income represented by the judgments are determined as follows:

(1) Abnormal income		$1,000,000
(2) Less 125 percent of average income ($300,000) for the four previous taxable years		375,000
(3) Excess of (1) over (2)		625,000
(4) Less an amount bearing same ratio to $160,000 (deductions applicable to items in this class) as $625,000 bears to $1,000,000		100,000
(5) Net abnormal income		525,000
(6) Gross income on account of the judgment against X	$800,000	
(7) Less deductions applicable to such item	160,000	
(8) Amount of (6) reduced by (7)		640,000
(9) Gross income on account of the judgment against Y	$200,000	
(10) Less deductions applicable to such item	None	
(11) Amount of (9) reduced by (10)		200,000
(12) Aggregate of (8) and (11)		840,000
(13) Portion of net abnormal income allocated to the judgment against X (640,000/840,000 of $525,000)		400,000
(14) Portion of net abnormal income allocated to the judgment against Y (200,000/840,000 of $525,000)		125,000

Example (2). For the taxable year 1942, the A Corporation has $134,062.50 net abnormal income from the two oil leases which it developed. One lease, on the X field, produced an average of $60,000 a year during the four previous taxable years, and $85,000 in 1942. There were $6,800 direct expenses applicable to this lease. The other lease, on the Y field, produced no income in the four previous years. In 1942, there were $38,200 direct expenses applicable to this lease. The lease produced $155,000 income in 1942. The item of net abnormal income represented by the X lease is $9,788.69, and the item represented by the Y lease is $124,273.81, computed as follows:

(1) Gross income on account of the X lease		$85,000.00
(2) Less 125 percent of average income of this lease for the four previous taxable years (125 percent of $60,000)		75,000.00
(3) Item (1) less item (2)		10,000.00
(4) Less amount bearing same ratio to $6,800 (expenses applicable to this lease) as $10,000 bears to $85,000		800.00
(5) Income from X lease reduced on account of average income and applicable expenses		9,200.00
(6) Gross income on account of Y lease	$155,000.00	
(7) Less 125 percent of average income for the four previous taxable years	None	
(8) Item (6) less item (7)	155,000.00	
(9) Less amount bearing same ratio to $38,200 (expenses applicable to this lease) as $155,000 bears to $155,000	38,200.00	
(10) Income from Y lease reduced on account of average income and applicable expenses		116,800.00
(11) Aggregate of item (5) and item (10)		126,000.00
(12) Portion of net abnormal income allocated to the X lease (9,200/126,000 of $134,062.50)		9,788.69
(13) Portion of net abnormal income allocated to the Y lease (116,800/126,000 of $134,062.50)		124,273.81

§ 35.721–2 *Classification of income.* Section 721 (a) (2) (A), (C), (D), (E), and (F) sets forth five separate classes of income. Income which does not fall within those provisions may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such other classes as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice.

All the income which reasonably is classifiable in more than one class shall be classified under the one which the taxpayer irrevocably elects. Such election shall be made in the manner prescribed in § 35.721–3.

The classification of income in any year must be consistent with the classification made under section 721 for previous years. The classification must also be consistent with any classification made in applying to the taxpayer section 711 (b) (1) (H), (I), or (J), and section 736.

Income from contracts the performance of which requires more than 12 months is a class of income. In the case of a taxpayer which does not make the election provided in section 736 (b), any such income derived in an excess profits tax taxable year beginning before January 1, 1942, and attributable under the provisions of § 30.721–7 of this chapter to future taxable year beginning after December 31, 1941, shall be included in gross income for such future taxable year as provided in § 35.721–5. However, any such income derived in an excess profits tax taxable year beginning after December 31, 1941, shall not be considered as abnormal income for the purposes of section 721.

§ 35.721–3 *Amount attributable to other years.* The mere fact that an item includible in gross income is of a class abnormal either in kind or in amount does not result in the exclusion of any part of such item from excess profits net income. It is necessary that the item be found attributable under these regulations in whole or in part to other taxable years. Only that portion of the item which is found to be attributable to other years may be excluded from the gross income of the taxpayer for the year for which the excess profits tax is being computed.

Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in such amounts as are reasonable in the light of such events. To the extent that any items of net abnormal income in the taxable year are the result of high prices, low operating costs, or increased physical volume of sales due to increased demand for or decreased competition in the type of product sold by the taxpayer, such items shall not be attributed to other taxable years. Thus, no portion of an item is to be attributed to other years if such item is of a class of income which is in excess of 125 percent of the average income of the same class for the four previous taxable years solely because of an improvement in business conditions. In attributing items of net abnormal income to other years, particular attention must be paid to changes in those years in the factors which determined the amount of such income, such as changes in prices, amount of production, and demand for the product. No portion of an item of net abnormal income is to be attributed to any previous year solely by reason of an investment by the taxpayer in assets, tangible or intangible, employed in or contributing to the production of such income.

Section 721 has no effect upon the computation of base period net income or of earnings and profits and therefore does not affect the computation of the excess profits credit. Similarly, it has no application in the determination of taxes other than the excess profits tax imposed by Subchapter E of Chapter 2 (except where the excess profits tax or the credit provided in section 26 (e) is applicable in the computation of other taxes). Amounts attributed to future years are to be included in gross income for such years for excess profits tax purposes only. If the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation prior to the close of the last future year to which any such amounts are attributable, then all amounts of net abnormal income attributable to years subsequent to both:

(a) The first year in which such transfer or distribution in liquidation occurs, and

(b) The taxable year in the gross income of which such abnormal income would have been included except for section 721

shall be included in the gross income for the year referred to in (a) or the year referred to in (b), whichever is the later. For example, if a taxpayer realizes in 1944 net abnormal income attributable to the years 1942 to 1946, inclusive, and in 1945 begins to distribute its property in complete liquidation, the portion of the net abnormal income attributable to the future year 1946 is to be reallocated to and included in the gross income for 1945 (the first year of liquidation) in addition to the amount already attributed to that year. If the first distribution in liquidation occurred before the year of realization, for example, in 1943, the portions of the net abnormal income attributable to the future years 1945 and 1946 would be included in the gross income for 1944 (the year of realization) in addition to the amount already attributed to that year. In neither event will the allocations originally made to 1942, 1943, and 1944 be disturbed.

Specific methods of treating items of net abnormal income of the five classes specified in section 721 (a) are set forth in §§ 35.721–6 to 35.721–10. These methods are to be applied subject to the provisions of this section.

A taxpayer claiming the benefits of section 721 shall file with its excess profits tax return a detailed statement in duplicate containing the following information:

(1) The amount and a description of each class of income claimed to be abnormal, and the amount and a description of each item in each such class;

(2) For each class of income claimed to be abnormal, the amount and a description of each item of income of the same class derived during the four tax-

able years immediately preceding the taxable year, and the aggregate amount of such items for each taxable year;

(3) For each class of income claimed to be abnormal, the amount of net abnormal income, the amount of each item of net abnormal income, and the computations by which these amounts were determined;

(4) The transactions in which each such item had its origin, the method used in allocating such item, the amount allocated to each year, and the reasons therefor; and

(5) All other facts upon which the taxpayer relies.

If any item of income is reasonably classifiable in more than one class, the inclusion of such item in any one of such classes in the statement referred to above shall constitute an irrevocable election by the taxpayer for the purpose of section 721 (a) (2).

§ 35.721–4 *Computation of tax for current taxable year.* The excess profits tax for the taxable year shall be the smaller of the following amounts:

(a) The excess profits tax computed without excluding from gross income any amounts attributable to other years under section 721, and so computed with the application of section 721 (d), relating to the tax for future taxable years to which net abnormal income is attributable, if such section is applicable to such taxable year; or

(b) The sum of (1) the excess profits tax for the taxable year computed without including in gross income the amount of items of net abnormal income attributable to other taxable years, and so computed with the application of section 721 (d) if such section is applicable, and (2) the aggregate of the amounts of additional excess profits tax which would have resulted for the taxable year in the computations under (1) of this paragraph and for each previous excess profits tax taxable year if there had been included in the gross income for each previous taxable year the amount of the items, if any, of the net abnormal income attributable thereto. If the excess profits tax for any previous taxable years was computed under section 721, the increases in tax under (2) of this paragraph shall be computed on the basis of the computations made for such previous taxable years, that is, as if the gross income for all previous taxable years included the items of net abnormal income attributable to such previous taxable years from the other previous taxable years to which section 721 applied.

Since the net abnormal income attributable to any taxable year, if included in the gross income for such taxable year, would reduce items, such as the net operating loss or unused excess profits credit, for such year which are taken into account in other taxable years through a carry-over or carry-back, such inclusion in gross income may also result in an increase in tax in such other taxable years in which such loss or unused credit is taken into account in computing the net operating loss deduction or unused excess profits credit adjustment. Section 721 requires that the increase in tax for the taxable year in which such net operating loss deduction or unused excess profits credit adjustment would be affected by the attributed income must be taken into account in computing the tax under section 721. Such income shall not be included in determining the net abnormal income for the taxable year to which it is attributable. The increase in tax caused by any adjustment under section 721 is the difference between the tax computed without such adjustment and the tax computed after making such adjustment.

The computations required by section 721 (c) may be illustrated by the following examples:

Example (1). The taxpayer, on the calendar year basis, sustains a net operating loss in 1941 which forms the basis for a net operating loss deduction of $10,000 for 1942. In 1942 it has $6,000 net abnormal income, all of which is attributable to 1941. Although there would be no increase in excess profits tax for 1941 if the $6,000 net abnormal income were included in gross income for that year, the $6,000 would offset the $10,000 net operating loss for 1941. Therefore, the net operating loss deduction for 1942 would be reduced to $4,000 and the excess profits tax for 1942 would be increased to the extent caused by such reduction of the net operating loss deduction. The tax for 1942 is whichever is less of the following:

(i) The tax for 1942 computed without excluding any net abnormal income from gross income, or

(ii) The tax for 1942 computed after excluding from gross income the $6,000 net abnormal income attributable to 1941, plus the increase in the tax so computed which would result if, by reason of the $6,000 being included in gross income for 1941, the net operating loss deduction available in computing excess profits net income for 1942 were only $4,000 instead of $10,000.

The taxpayer had net income and adjusted excess profits net income for 1942 after giving effect to the net operating loss deduction of $10,000. For 1943 it has $8,000 net abnormal income, all of which is attributable to 1941. The tax for 1943 is whichever of the following is the lesser:

(A) The tax for 1943 computed without excluding any net abnormal income from gross income; or

(B) The tax for 1943 computed after excluding from gross income the $8,000 net abnormal income attributable to 1941, plus the increase in the tax for 1941 and 1942 which would be caused by the reduction in the net operating loss for 1941 if the $8,000 were included in gross income for 1941 so that it offset the net operating loss sustained in that year. In making these computations for 1941 and 1942, the adjustments made for those years in applying section 721 (c) to 1942 are retained, that is, the $6,000 net abnormal income attributable to 1941 from 1942 in applying section 721 to 1942 is treated as if it remained in gross income for 1941, and the $6,000 net abnormal income attributable to 1941 from 1942 is not included in the gross income for 1942 and the net operating loss deduction for that year (prior to any adjustment caused by applying section 721 (c) to 1943) is treated as being $4,000, not $10,000.

Example (2). The taxpayer, on the calendar year basis, has $50,000 net abnormal income in 1940 attributable in the amount of $10,000 to each of the years 1941 to 1945. This $10,000 amount is therefore included in gross income for each of these years. In 1945 it has $60,000 net abnormal income, all of which is attributable to 1943. The tax for 1945 is whichever of the following is the lesser:

(i) The tax for 1945 computed under section 721 (d) without excluding any net abnormal income for 1945 from gross income; or

(ii) The tax for 1945 computed under section 721 (d) after excluding the $60,000 net abnormal income for 1945 from gross income, plus the increase in the tax for 1945 as so computed, if any, and the increase in tax, if any, for all previous taxable years which would result if the $60,000 net abnormal income were included in gross income for 1943.

For any taxable year for which the excess profits tax or the increase in excess profits tax is determined under section 721 (c), the excess profits tax may be computed pursuant to the provisions of section 710 (a) (1) (B) (if such section is applicable to such year) as an amount which when added to the normal tax and surtax for the year is equal to 80 percent of the corporation surtax net income for such year determined under section 15 or Supplement G of Chapter 1 (relating to insurance companies) but without regard to the credit provided in section 26 (e) (relating to income subject to excess profits tax), as follows:

If the provisions of section 710 (a) (1) (B) are applicable for the purposes of paragraph (a) of this section, the normal tax and surtax shall be the actual normal tax and surtax for the taxable year computed under Chapter 1, and the corporation surtax net income shall be the actual corporation surtax net income computed under Chapter 1 or, if the excess profits tax is computed under section 721 (d), the corporation surtax net income determined for the purposes of section 721 (d). See § 35.721–5. If the provisions of section 710 (a) (1) (B) are applicable for the purposes of subparagraph (1) of paragraph (b) of this section, the normal tax and surtax shall be the actual normal tax and surtax for the taxable year computed under Chapter 1, and the corporation surtax net income shall be the corporation surtax net income described in the preceding sentence except that the amount of any items of net abnormal income attributable to other taxable years shall be excluded from gross income. If the provisions of section 710 (a) (1) (B) are applicable for the purposes of subparagraph (2) of paragraph (b) of this section, the normal tax and surtax for a previous taxable year shall be the actual normal tax and surtax for such year computed under Chapter 1, and the corporation surtax net income for such year shall be the corporation surtax net income described in the first sentence of this paragraph increased by the total amount of the items of net abnormal income attributable to such prior year.

§ 35.721–5 *Computation of tax for future taxable years.* Amounts of items of net abnormal income attributable to a future taxable year shall be included in the gross income for such future taxable year for the purposes of the excess profits tax, except that if in the application of section 721 (d) (1) to any future taxable year it is determined that the decrease in tax computed under section 721 (d) (1) (B) for the taxable year in which the net abnormal income was realized does not exceed the aggregate

of the increases in tax for other taxable years with respect to such net abnormal income, as computed under section 721 (d) (1) (B), then no portion of such net abnormal income shall be included in gross income for any taxable year subsequent to such future taxable year. For example, in 1940 the taxpayer, on the calendar year basis, has $60,000 net abnormal income, of which $10,000 is attributable to each of the years 1941 to 1946. In applying section 721 (d) to 1943, it is determined that the decrease in tax for 1940 caused by the application of section 721 (c) (computed with the exclusion of the net abnormal income from gross income) does not exceed the increases in tax for 1941 and 1942 caused by the inclusion in gross income of the net abnormal income attributable to those years. Therefore, the net abnormal income for 1940 attributable to 1944, 1945, and 1946 shall not be included in gross income for those years.

The excess profits tax is determined as the lesser of the amounts computed under section 710 (a) (1) (A) (90 percent of the adjusted excess profits net income) and section 710 (a) (1) (B). Under section 710 (a) (1) (B), the excess profits tax is an amount which when added to the normal tax and surtax for the year is equal to 80 percent of the corporation surtax net income for such year determined under section 15 or Supplement G of Chapter 1 (relating to insurance companies) but without regard to the credit provided in section 26 (e) (relating to income subject to excess profits tax). For the purpose of applying section 710 (a) (1) (B) to a future taxable year to which amounts of items of net abnormal income are attributable, which amounts are included in gross income for such year for excess profits tax purposes under section 721 (d), the normal tax and surtax shall be the actual normal tax and surtax for the taxable year computed under Chapter 1, and the corporation surtax net income shall be computed on the basis of the gross income determined under section 721 for the purposes of the excess profits tax for such taxable year.

If net abnormal income is included in the gross income for any future taxable year, and if the tax for such year is the amount determined under the limitations of section 721 (d) (1) with respect to such net abnormal income, then for the purpose of computing the net operating loss deduction or unused excess profits credit adjustment for any taxable year subsequent to such future taxable year the gross income for the future taxable year shall be deemed to include only such portion of the net abnormal income as, when added to the other gross income for such future taxable year, would result without the application of section 721 (d) (1) in an excess profits tax equal to the amount determined under that section. For example, $50,000 net abnormal income for 1942 it attributable to 1945, and is included in the gross income for that year. The excess profits tax for 1945 computed without the application of section 721 (d) (1) is $145,000. Under section 721 (d) (1), the excess profits tax is determined to be $118,000. If only $20,000, instead of $50,000, had been included as net abnormal income in the gross income for 1945, the excess profits tax for that year without the application of section 721 (d) (1) would be $118,000. Therefore, for the purpose of computing the net operating loss deduction or unused excess profits credit adjustment for any taxable year subsequent to 1945, the gross income for 1945 is considered to include $20,000 and not $50,000 net abnormal income.

Section 721 (d) (1) provides that the excess profits tax for a future taxable year to which any portion of the net income for a previous taxable year is attributed is the smaller of the amounts determined under (a) and (b) below:

(a) The excess profits tax for such year computed with the inclusion in gross income of such portion of the net abnormal income;

(b) The sum of:

(1) The excess profits tax for such year computed without the inclusion in gross income of such portion of the net abnormal income, and

(2) The excess of:

(i) The decrease in excess profits tax for the year of realization which resulted from the exclusion of net abnormal income from the gross income for such year, over

(ii) The aggregate of the increase in excess profits tax for the future taxyear (as determined under (1) of this paragraph) and for intervening years resulting from the inclusion in the gross income for such intervening years of the other portions of such net abnormal income.

If net abnormal income from more than one previous taxable year is attributed to the future taxable year, the determinations under (a) and (b) of this section are to be made first with respect to the portion of net abnormal income attributed from the earliest previous taxable year, the portions of net abnormal income from the later taxable years being treated as ordinary income for such future taxable year. The determinations under (a) and (b) are then to be made with respect to the portion of net abnormal income attributed from the next earliest previous taxable year, and for such purpose the excess profits tax for the future taxable year determined under (a) is considered the excess profits tax resulting from the determinations under (a) and (b) with respect to the net abnormal income attributed from the earliest previous taxable year, and the gross income referred to in (b) is considered that amount which would result in the tax reported under (a) if section 721 (d) (1) did not apply. The determinations for the other previous taxable years from which net abnormal income is attributed to the future taxable year are to be made in a similar manner in the order of such taxable years, and the amount so determined for the latest of such taxable years is the tax under section 721 (d) (1) of the future taxable year. The foregoing provisions are illustrated by the following example:

Example. A taxpayer, on the calendar year basis, has net abnormal income for 1941, of which $10,000 is attributed to 1945, and net abnormal income for 1942, of which $20,000 is also attributed to 1945. The tax for 1945, before the application of section 721 (d) (1), is $90,000. The adjusted excess profits net income for 1945 is $100,000, and the gross income and other amounts necessary to determine this amount are such that a decrease in gross income (if such decrease is $100,000 or less) causes a decrease of an equal amount in adjusted excess profits net income. For the purpose of applying section 721 (d) (1) to 1945, computations under (a) and (b) are first made only with respect to the $10,000 attributed from 1941, and the $20,000 attributed from 1942 is not considered net abnormal income. Upon this computation, the tax under (a) is $90,000. The tax under (b) (1), determined by excluding the $10,000 from gross income, is $81,000. Assuming that the amount determined under (b) (2) with respect to the $10,000 net abnormal income is $4,500, the excess profits tax would then be determined under (b) as $85,500, a lesser amount than the $90,000 computed under (a). The computations under (a) and (b) are then made with respect to the $20,000 attributed from 1942. For this purpose, the tax under (a) is considered to be the $85,500 amount computed with respect to the net abnormal income attributed from 1941. For the purposes of (b), the taxpayer is considered to have such gross income and other items of deductions and credits as would produce the tax of $85,500 determined with respect to the net abnormal income attributed from 1941. That is, the gross income is considered reduced by $5,000, the items of deductions and credits remaining the same, so that the adjusted excess profits net income is reduced to $95,000, on which amount the tax would be $85,500. The exclusion of $20,000 from that amount of gross income which would produce $95,000 adjusted excess profits net income would reduce such adjusted excess profits net income to $75,000, on which the tax is $67,500, and this $67,500 amount is considered the tax under (b) (1) determined by excluding the $20,000 from gross income. Assuming that the amount determined under (b) (2) with respect to the $20,000 net abnormal income is $7,500, then the tax finally determined under section 721 (d) (1) for the future taxable year would be $75,000, the sum of $67,500 and $7,500, which is a lesser amount than the $85,500 determined under (a).

If part of the income for a future taxable year, to which year net abnormal income of previous years is attributed, constitutes net abnormal income for such future year which is attributable to other taxable years, then the computations under section 721 (d) (1) shall be made without regard to the provisions of section 721 (c) which apply in determining the tax for such future taxable year. Section 721 (c) is applied after the tax is determined under the limitations of section 721 (d). In determining for the purpose of section 721 (d) (1) the increases and decreases in tax for previous taxable years, portions of net abnormal income for any of such previous taxable years attributable under section 721 (c) to other of such previous taxable years shall be treated as remain-

ing in gross income in the years to which attributed.

This section may be illustrated by the following example:

Example. In the taxable year 1940, the A Corporation realized $26,000 net abnormal income, $2,000 of which is attributed to the taxable year 1940 and $4,000 to each of the taxable years 1941 through 1946. For the years 1940 through 1942, the adjusted excess profits net income, computed with these attributed amounts included in gross income, and the resulting excess profits tax are as follows:

	Adjusted excess profits income	Excess profits tax
1940	$4,000	$1,000
1941	54,000	20,800
1942	104,000	93,600

The adjusted excess profits net income for 1943, after the inclusion in gross income of the amount attributed to such year, is $124,000. The excess profits tax for such year is $109,000, computed as follows:

(a) Tax on $124,000 computed without regard to the limitations of section 721 (d)		$111,600
(b) (1) Tax on $120,000 (income for 1943 excluding amount attributed to such year)		108,000
(2) (i) Tax for 1940 if section 721 were not applied to the net abnormal income for such year (tax on sum of $4,000 plus the $24,000 attributed to other years, or a total of $28,000)	$7,400	
(ii) Less tax for 1940 after application of section 721	1,000	
(iii) Decrease in tax for 1940 due to application of section 721		6,400
(3) (i) Tax for 1941 after application of section 721	$20,800	
(ii) Less tax for 1941 if attributed income of $4,000 were excluded from gross income (tax on $50,000)	19,000	
(iii) Increase in tax for 1941 due to inclusion of attributed income	1,800	
(4) (i) Tax for 1942 after application of section 721	93,600	
(ii) Less tax for 1942 if attributed income of $4,000 were excluded from gross income (tax on $100,000)	90,000	
(iii) Increase in 1942 tax due to inclusion of attributed income	3,000	
(5) Aggregate of increases in tax for intervening years 1941 and 1942 (item (3) (iii) plus item (4) (iii))		5,400
(6) Excess of decrease in tax for 1940 over aggregate of increases in tax for intervening years 1941 and 1942 (item (2) (iii) minus item (5))		1,000
(7) Sum of tax on income for 1943, excluding amount attributed to such year, plus excess of decrease in tax for 1940 over aggregate of increases in tax for 1941 and 1942 (item (1) plus item (6))		109,000

Since the amount computed in (b) (7), $109,000, is less than the amount computed in (a), $111,600, the excess profits tax of the A Corporation for 1943 is $109,000, the smaller amount.

In the above example, the decrease in tax for 1940 ($6,400) has been equaled by the aggregate of the increases in tax for the intervening years 1941 through 1943 ($1,800 plus $3,600 plus $1,000). Therefore, the $4,000 attributed to 1944, 1945, and 1946 will not be included in gross income for such years.

§ 35.721–6 *Income arising out of a claim, award, judgment, or decree, or interest thereon.* The first class of potentially abnormal income specifically set forth in section 721 (a) (2) is income arising out of a claim, award, judgment, or decree, or interest thereon. All items of such income are of the same class. Therefore, in determining whether income arising out of a judgment, for example, is abnormal either in kind or in amount, account must be taken not only of other judgment income, if any, received in preceding taxable years, but also of any income arising out of claims, awards, and decrees, and interest thereon, so received.

In determining the portions of income of the class described which are attributable to other taxable years, due regard shall be given to the nature of the claim upon which the recovery is founded. Allocation will generally be made to the year or years during which occurred the exploitation, removal, or use, as the case may be, of the property right forming the subject matter of the claim, award, judgment, or decree. Thus, in the case of a judgment for infringement of a patent, the number of units produced through the use by the infringer of such patent in the respective years involved shall constitute a proper basis of allocation. Similarly, if the removal of minerals forms the basis of the recovery, the units removed in the respective years shall constitute a proper basis of allocation. The income arising from awards of the Mixed Claims Commission, United States and Germany, to the extent they constitute compensation for past losses, shall be attributed to the years during which such losses occurred. Interest shall be attributed to the years for which it was allowed.

This section may be illustrated by the following example:

Example. Based upon encroachment by the Y Corporation upon mineral property, the X Corporation in 1942 obtains judgment for and payment of $350,000. The X Corporation has not in any prior year derived income from any like source; nor are there any direct expenses involved in obtaining the judgment which are deductible for 1942. This amount, therefore, represents the net abnormal income, and is the only item included therein. As the judgment is based upon $1 per ton for ore removed in each year, the amount received is allocated as follows:

Year	Tonnage	Income attributed
1941	150,000	150,000
1942	200,000	200,000
Total		350,000

There was no net operating loss deduction or unused excess profits credit adjustment in 1941 or 1942. For the purposes of the computation of the excess profits tax there shall be included in gross income for the year 1942 the amount of $200,000. The amount of $150,000 allocated to 1941 affects the total 1942 excess profits tax as explained below.

The excess profits tax for the year 1942 shall be determined as follows:

(1) An excess profits tax for 1942 shall be computed without regard to section 721, that is, by including in gross income the item of $350,000, and

(2) A partial excess profits tax for 1942 shall be computed on the net income arrived at by including in gross income only $200,000 of the item of $350,000, and to the partial tax so computed there shall be added the increase in the excess profits tax which would result from the inclusion in gross income for the year 1941 of $150,000 of the item of $350,000.

The excess profits tax for 1942 is either (1) or (2), whichever is the lesser.

To arrive at the increase in the excess profits taxes for 1941 which would result from the inclusion in the gross income for such year of $150,000 of the item of $350,000 the excess profits tax shall (but only for the purpose of determining the 1942 excess profits tax liability) be computed first by including the item of $150,000 in the gross income, and second by excluding such amount from the gross income. The excess of the amount obtained as the result of the first computation over the amount obtained as the result of the second computation represents such increase.

If in the above example, in addition to the principal amount, interest had been added to the judgment, such interest would be also properly allocable as between 1942 and 1941 in accordance with the method sanctioned by the court in settling the amount of such interest. If the portion of the total interest attributable to the respective years cannot be ascertained from the judgment, such interest may be allocated among such years, upon the basis of the respective portions of the principal amount attributable to such years, giving effect to the period of time each portion remained unpaid.

§ 35.721–7 *Exploration, discovery, prospecting, research, or development.* The second class of potentially abnormal income specifically set forth in section 721 (a) (2) is income resulting from exploration, discovery, prospecting, research, or development of tangible property (such as mines, oil producing property, and timber tracts), patents, formulae, or processes, or any combination thereof, extending over a period of more than 12 months. The exploration, discovery, prospecting, research, or development must be that of the taxpayer. Income resulting from activities of such a character carried on by a predecessor is not entitled to the treatment provided in section 721.

An item of income resulting from exploration, discovery, prospecting, research, or development is all such income for the taxable year arising out of a unit of property such as an oil lease or other mineral property defined in § 29.33 (m)–1 (i) of this chapter, a patent, or a formula. If the taxpayer engages in manufacturing, marketing, mining, oil production or similar activities, only such portion of the resulting income as is attributable to exploration, discovery, prospecting, research, or development is within the class of income described in this section. For example, the A Corporation develops a patented device and itself manufactures and sells such device. It also permits other corporations to manufacture such device upon payment of a royalty of $10 for each device produced. Income resulting from the development of the device is the sum of the royalties included in income and so much of the income arising out of the sale of the units manufactured by the taxpayer itself as does not exceed $10 for each device so manufactured and sold.

In general, an item of net abnormal income of the class described in this section is to be attributed to the taxable years during which expenditures were made for the particular exploration, discovery, prospecting, research, or development which resulted in such item being realized and in the proportion which the amount of such expenditures made during each such year bears to the total of such expenditures. Allocation of items of net abnormal income of the class described in this section must be made according to the principles set forth in § 35.721–3.

Exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing extending over a period of more than 12 months occurring during or immediately prior to the base period may constitute the basis of a claim under section 722 (b) that the average base period net income is an inadequate standard of normal earnings and for the establishment of a constructive average base period net income under section 722 (a). In such case, if the constructive average base period net income determined by taking into account the activities described in section 721 (a) (2) (C) and in the preceding sentence is higher than it would be if such activities are not taken into account, only that portion of the net abnormal income for the taxable year resulting from such activities, which is of a class described in section 721 (a) (2) (C) and this section, as is attributable to another excess profits tax taxable year shall be deemed attributable to a year other than the taxable year. No amount of such net abnormal income shall be attributed to any year in the taxpayer's base period or to any year prior thereto.

This section may be further illustrated by the following examples:

Example (1). In January, 1940, the X Corporation began the development of a certain device on which it expended considerable sums. The corporation secures a patent on such device in December, 1942, and in the same month sells such patent at a profit. It did not in any of the four immediately preceding years derive income of the class specified in section 721 (a) (2) (C). The net abnormal income represented by this item is $250,000. In 1940, the corporation expended $50,000 on the development of this device, $100,000 in 1941, and $150,000 in 1942, a total of $300,000. For excess profits tax purposes, one-sixth (50,000/300,000) of the item of $250,000 is, therefore, attributable to 1940; one-third (100,000/300,000) is attributable to 1941; and one-half (150,000/300,000) is attributable to 1942. For method of computation of the excess profits tax for the year 1942, see § 35.721–4.

Example (2). In 1941, the A Corporation purchased from X, an inventor, the rights to a device he was developing, paying him $4,500 for such rights. In perfecting the device, the corporation spent $3,000 in 1941 and $6,000 in 1942, or a total of $9,000. A patent was obtained on the device in 1942, and it was licensed for use in the industry. The corporation had a $15,000 item of net abnormal income in 1942 as a result of the royalties received for the use of this device. Of this item, $5,000 ($^{3000}/_{9000}$ of $15,000) is attributable to 1941, and may be excluded from gross income for the year 1942 in the computation of excess profits tax for that year. For method of computation of the excess profits tax for the year 1942, see § 35.721–4 and the example in § 35.721–6.

Example (3). In 1937, the B Corporation, which had been engaged in manufacturing and selling patented products under licensing agreements with the patent holders, discontinued such practice and devoted its facilities to research and development of new products. In 1938 and 1939, the corporation secured several patents and started selling the products which it manufactured under such patents. In 1940 and in subsequent years, the corporation received net abnormal income as a result of such sales. The corporation has made an application for relief under section 722 (b) (4) on the ground that it had changed the character of its business during the base period, and that its average base period net income does not reflect the normal operation for the entire base period of the business. The constructive average base period net income finally determined is higher than it would have been if the activities referred to and engaged in by the corporation in 1938 and 1939 had not occurred and were not taken into account under section 722. Consequently no part of any net abnormal income determined under section 721 (a) (2) (C) and this section shall be deemed to be attributable to 1937, 1938, or 1939.

§ 35.721–8 *Change in accounting period or method of accounting.* The third class of potentially abnormal income specifically set forth in section 721 (a) (2) is income which is includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting. This class may include such items of income as are includible in gross income for the taxable year by reason of a change from the installment method to the straight accrual method of accounting, a change in inventory method, or a change from the reserve method to the specific charge-off method for the treatment of bad debts. Items of net abnormal income includible in gross income for the taxable year rather than for a different taxable year by reason of a change from the installment method to the straight accrual method of accounting shall be attributed to the year or years such items accrued. The method of allocating items of net abnormal income includible in gross income for the taxable year rather than for a different year by reason of other changes in accounting method or changes in accounting period is to be determined in each particular case upon consideration of all the facts in the case. (See § 35.721–3 as to the statement required to be filed where the benefits of section 721 are claimed.)

This section may be illustrated by the following example:

Example. The Y Corporation, prior to the calendar year 1942, reported its income on the installment basis. For the year 1942 it secures the consent of the Commissioner to a change in the method of reporting income to the straight accrual basis.

The gross income for the year 1942 computed under the straight accrual method of accounting and without regard to section 721 is as follows:

From installment sales contracts made in 1942	$320,000
From installment collections in 1942 on sales contracts made prior to 1942	250,000
From installment sales contracts made prior to 1942 but not yet collected	130,000
Total	700,000

Under the provisions of § 35.721–3, the items of net abnormal income included in the abnormal income of $380,000 resulting from sales contracts made prior to 1942 are to be attributed to the years in which such contracts were made. For method of computation of the excess profits tax for the year 1942, see § 35.721–4 and the example in § 35.721–6.

§ 35.721–9 *Income derived by lessor from termination of lease.* The fourth class of potentially abnormal income specifically set forth in section 721 (a) (2) is amounts included in the gross income of a lessor for the taxable year by reason of the termination of the lease. Income derived by reason of the fact that improvements made by the lessee upon leased property come into the possession or the control of the lessor upon termination or forefeiture of the lease is income of such class, except to the extent such income is excluded from gross income under section 22 (b) (11) for taxable years beginning after December 31, 1941. Other income derived by a lessor by reason of the termination of the lease and not excluded from gross income under section 22 (b) (11) (see § 29.22 (b) (11)–1 of this chapter) is also income of such class. If such other income includible in gross income is abnormal either in kind or in amount, the resulting item of net abnormal income is to be attributed to the taxable year in which such item is realized and prior or subsequent taxable years in the light of the agreement underlying the realization of such item. If, for instance, the lessee pays a lessor a lump sum as consideration for the cancellation of a lease, the resulting item of net abnormal income, if any, shall be attributed ratably to the taxable years included in what would have been the remaining life of the lease had such lease not been canceled.

Income derived in an excess profits tax taxable year beginning before January

1, 1942, by reason of the fact that improvements made by the lessee upon the leased property came into the possession or control of the lessor upon termination or forfeiture of the lease may result in the allocation of net abnormal income under section 721 to taxable years beginning after December 31, 1941. In such cases, if the income includible is abnormal either in kind or in amount, the resulting item of net abnormal income shall be allocated in accordance with the following rules:

(a) If the lease has not been canceled or forfeited, but has merely expired, the amount of such item shall be spread over the life of the lease:

(b) If the lease has been canceled or forfeited, but the remaining useful life of the improvement is not in excess of what would have been the remaining life of the lease had the cancellation or forfeiture not occurred, the amount of such item shall be spread over what would have been the remaining life of the lease;

(c) If the lease has been canceled or forfeited and the remaining useful life of the improvement is in excess of what would have been the remaining life of the lease had the cancellation or forfeiture not occurred, then:

(1) An amount which bears the same ratio to the item of net abnormal income as the period which would have constituted the remaining life of the lease bears to the remaining useful life of the improvement shall be spread over what would have been the remaining life of the lease, and

(2) The remaining portion of the item shall be spread over the life of the lease, including what would have been its remaining life had the cancellation or forfeiture not occurred.

Amounts attributed to each future taxable year (including any taxable year beginning after December 31, 1941) are to be included in gross income for such year for the purpose of computing the excess profits tax. See § 35.721–5. This paragraph may be illustrated by the following example:

Example. On January 1, 1929, the A Corporation, which makes its income tax returns on the calendar year basis, leased to the X Corporation an unimproved site. The latter corporation completed a building on this site on June 30, 1931. Such lease was for a period of 20 years and by its terms expired on December 31, 1948. On July 1, 1940, the lease is forfeited and the building comes into the possession and control of the A Corporation. The value of the building as of such date is $100,000, and its remaining useful life is 16 years. The A Corporation did not, prior to 1940, derive gross income of this nature, nor did it report as gross income any amount with respect to the erection of the building. In 1940 there were no direct costs or expenses attributable to the realization of such income. The net abnormal income for this item is, therefore $100,000. Since the remaining useful life of the improvement is 16 years, but what would have been the remaining life of the lease is only 8½ years, $\frac{8\frac{1}{2}}{16}$ of $100,000, or $53,125, is to be spread over what would have been the remaining life of the lease, *i. e.*, the last half of 1940, and the calendar years 1941 to 1948, both inclusive. Since there are 17 half-years in such period, $\frac{1}{17}$ of $53,125, or $3,125, is to be allocated to the last half of 1940, and $\frac{2}{17}$ of $53,125, or $6,250, to each of the calendar years 1941 to 1948, both inclusive. The remainder of the $100,000 item, or $46,875 ($100,000 minus $53,125), is to be spread over the years 1929 to 1948, both inclusive, *i. e.*, $\frac{1}{20}$ of $46,875, or $2,343.75, is to be allocated to each such year. The total amount allocable to each year is as follows:

Years:	*Amount per year*
1929–1939	$2,343.75
1940—	
Portion of $53,125 allocated to last half of year	3,125.00
Plus: Portion of $46,825 allocated to such year	2,343.75
Total	5,468.75
1941–1948—	
Portion of $53,125 allocated to each year	6,250.00
Plus: Portion of $46,825 allocated to each year	2,343.75
Total	8,593.75

The amounts allocated to the years 1929 to 1939, both inclusive, will have no effect upon the computation of the excess profits tax. The amounts attributed to 1942 and subsequent years must be included in gross income for such years for the purpose of computing the excess profits tax, as provided in § 35.721–5.

§ 35.721–10 *Dividends on stock of foreign corporations other than foreign personal holding companies.* The fifth class of potentially abnormal income specifically set forth in section 721 (a) (2) is dividends on stock of foreign corporations, except foreign personal holding companies. This section is applicable only to the extent that such dividends are not excluded from excess profits net income under section 711 (a) (2) (A), and therefore does not apply in the computation of the excess profits tax when the excess profits credit based on invested capital is used unless the stock on which the dividends were received is not a capital asset. In determining whether the class of income described in this section is abnormal or in excess of 125 percent of the average income of the same class for the four preceding taxable years, only dividends received from foreign corporations are to be taken into account. The exception relative to dividends from foreign personal holding companies applies both to distributions actually received from foreign personal holding companies and to constructive dividends deemed to have been received pursuant to section 337.

Items of net abnormal income of the class herein described are to be attributed to the years in which were accumulated the earnings and profits out of which the distributions were made, if accumulated after the acquisition by the distributee of the stock of the distributing corporation. If the earnings and profits out of which the distribution is made were accumulated prior to such acquisition, the income arising out of the distribution is to be attributed to the taxable year in which the stock was acquired. The earnings and profits out of which any distribution is made are, as provided in section 115, the most recently accumulated earnings and profits.

This section may be illustrated by the following example:

Example. The X Corporation, a domestic corporation, computing its excess profits credit on the income basis, acquired in 1938 all of the stock of the Y Company, Ltd., a foreign corporation, which is not a foreign personal holding company. The Y Company, Ltd., paid in July, 1942, a dividend to the X Corporation in the amount of $100,000. The X Corporation did not previously receive dividends from this or any other foreign corporation. In 1942 there were no direct costs or expenses attributable to the receipt of this dividend. The $100,000 is therefore a single item of net abnormal income. The Y Company, Ltd., had earnings and profits of $75,000 in 1942 and $125,000 in 1941. Following principles of existing law with respect to the source from which dividends are deemed to have been paid, the $100,000 item of net abnormal income shall be allocated between the years 1942 and 1941 in the respective sums of $75,000 and $25,000. See section 115 (b) and corresponding provisions of prior revenue laws. For method of computation of the excess profits tax for the year 1942, see §35.721–4 and the example in § 35.721–6.

SEC. 722. GENERAL RELIEF; CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 6, Excess Profits Tax Amendments 1941, sec. 202 (g), Rev. Act 1941, sec. 222 (a), Rev. Act 1942, and by Public Law 21 (Seventy-Eighth Congress).]

(a) *General rule.* In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such costructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard shall be had to the change in the character of the business under section 722 (b) (4) or the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

(b) *Taxpayers using average earnings method.* The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) In one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry.

(3) the business of the taxpayer was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member, subjecting such taxpayer to

(A) a profit cycle differing materially in length and amplitude from the general business cycle, or

(B) sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period,

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier-time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or

(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

(c) *Invested capital corporations, etc.* The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer, not entitled to use the excess profits credit based on income pursuant to section 713, if the excess profits credit based on invested capital is an inadequate standard for determining excess profits, because

(1) the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income,

(2) the business of the taxpayer is of a class in which capital is not an important income-producing factor, or

(3) The invested capital of the taxpayer is abnormally low. In such case for the purposes of this subchapter, such taxpayer shall be considered to be entitled to use the excess profits credit based on income, using the constructive average base period net income determined under subsection (a). For the purposes of section 713 (g) and section 743, the beginning of the taxpayer's first taxable year under this subchapter shall be considered to be that date after which capital additions and capital reductions were not taken into account for the purposes of this subsection.

(d) *Application for relief under this section.* The taxpayer shall compute its tax, file its return, and pay its tax under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer, not later than six months after the date prescribed by law for the filing of its return, or if the application relates to a taxable year beginning after December 31, 1939, but not beginning after December 31, 1941, prior to September 16, 1943, makes application therefor in accordance with regulations to be prescribed by the Commissioner with the approval of the Secretary, except that if the Commissioner in the case of any taxpayer with respect to the tax liability of any taxable year—

(1) Issues a preliminary notice proposing a deficiency in the tax imposed by this subchapter such taxpayer may, within ninety days after the date of such notice make such application, or

(2) Mails a notice of deficiency (A) without having previously issued a preliminary notice thereof or (B) within ninety days after the date of such preliminary notice, such taxpayer may claim the benefits of this section in its petition to the Board or in an amended petition in accordance with the rules of the Board.

If the application is not filed within six months after the date prescribed by law for the filing of the return, or if the application relates to a taxable year beginning after December 31, 1939, but not beginning after December 31, 1941, prior to September 16, 1943, the operation of this section shall not reduce the tax otherwise determined under this subchapter by an amount in excess of the amount of the deficiency finally determined under this subchapter without the application of this section. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

(e) *Rules for application of section.* For the purposes of this section—

(1) The tax imposed by this subchapter shall be the tax before the allowance of the foreign tax credit pursuant to section 729 (c) and (d);

(2) In the case of a taxpayer, the average base period net income of which is computed under Supplement A, for the period for which the income of any other person is included in the computation of the average base period net income of the taxpayer, the taxpayer shall be treated as if such other person's business were a part of the business of the taxpayer.

(f) *Mining corporations.* In the case of a taxpayer to which section 711 (a) (1) (I) or section 711 (a) (2) (K) applies, if its constructive average base period net income is established under this section, there shall also be determined a fair and just amount to be used as normal output and normal unit profit for the purposes of section 735.

§ 35.722–1 *General rule.* Section 722 provides for the extension of excess profits tax relief for taxable years beginning after December 31, 1939, to any taxpayer subject to the excess profits tax which satisfies the conditions and limitations expressed in such section. Relief is available whether the actual excess profits credit of the taxpayer is based on income or on invested capital and regardless of when the first excess profits tax taxable year of the taxpayer begins. A taxpayer which claims relief and which is entitled to use the excess profits credit based on income under section 713 or Supplement A, regardless of which excess profits credit is actually used in computing the excess profits tax on its return, must establish that its business during the base period falls into one or more of the categories described in section 722 (b) in order to be eligible for relief. A taxpayer is considered to be entitled to use the excess profits credit based on income even though the excess profits credit based on invested capital produces a lower tax than the excess profits credit based on income (computed without the benefit of section 722) for any excess profits tax taxable year for which a claim for relief is made. A taxpayer which claims relief under section 722 and which is not entitled to use the excess profits credit based on income under section 713 or Supplement A must establish that its invested capital falls into one or more of the categories specified in section 722 (c) in order to become eligible for relief under section 722. In either case, once eligiblity for relief is established, the taxpayer will be deemed to be entitled to use the excess profits credit based on income and any relief to be extended under section 722 shall be in the form of a constructive average base period net income.

§ 35.722–2 *Constructive average base period net income*—(a) *In general.* If a taxpayer establishes:

(1) That the excess profits tax determined without regard to the provisions of section 722 results in an excessive and discriminatory tax, and

(2) What would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period.

the excess profits tax for the taxable year shall be determined by using the excess profits credit computed upon the basis of such constructive average base period net income in lieu of the actual excess profits credit based on income or invested capital, as the case may be.

The excess profits tax is excessive and discriminatory if in the instances described in section 722 (b) the excess profits credit based on income is an inadequate standard of normal earnings or if in the instances described in section 722 (c) the excess profits credit based on invested capital is an inadequate standard for determining excess profits. Excessive and discriminatory taxation may result if, in a proper case, the taxpayer is not allowed to compute its unused excess profits credit for purposes of the unused excess profits credit adjustment for prior or subsequent years upon the basis of the excess profits credit based on constructive average base period net income in lieu of the actual excess profits credit. For what constitutes an excessive and discriminatory tax, computed without the provisions of section 722, see §§ 35.722–3 and 35.722–4.

The constructive average base period net income is a fair and just amount rep-

resenting normal earnings to be attributed to the taxpayer with respect to years prior to the excess profits tax return period for the purposes of establishing a standard to be used in the computation of an excess profits tax based upon a comparison of normal earnings and earnings during the excess profits tax period. The determination of such constructive average base period net income must be made without regard to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring after December 31, 1939. Such events or conditions are deemed to be integral parts of the war economy; they cannot therefore be accepted as either accurate or reliable determinants of normal operations or normal earnings. Thus high war prices, swollen demand, and other factors which would not be normal in the experience of the business for years prior to the imposition of the excess profits tax shall not be considered in determining the normal earnings of the taxpayer. However, in certain cases involving a change in the character of the business consummated during a taxable year ending after December 31, 1939, as described in the last sentence of section 722 (b) (4) (see § 35.722–3 (d)), and in the case of a taxpayer first coming into existence as described in section 722 (c) (see § 35.722–4), regard shall be had to such change in the character of the business under section 722 (b) (4) or to the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

(b) *Rules for determination.* The determination of the constructive average base period net income must depend in each instance upon the facts and circumstances presented by the taxpayer and upon the provisions of section 722 forming the basis of the taxpayers' contention that its excess profits tax is excessive and discriminatory, i. e., if the taxpayer is entitled to use the excess profits credit based on income, the reasons why such credit is an inadequate standard of normal earnings, or if the taxpayer is not entitled to use such credit, the reasons why the excess profits credit based on invested capital is an inadequate standard for determining excess profits. No single test or standard of universal application can be prescribed pursuant to which every taxpayer must establish the fair and just amount representing normal earnings to be used as its constructive average base period net income. However, the following principles and rules must be observed in every case in which a constructive average base period net income is determined:

(1) Section 722 (a) provides for the determination of a constructive average base period net income to be used in lieu of the actual average base period net income is those cases to which section 722 is applicable. Since the constructive average base period net income is the fair and just amount representing normal earnings, a taxpayer in computing such amount is not, as a matter of right, entitled to use the rules provided by section 713 (e) (1), relating to increase in base period net income of lowest year of base period, or by section 713 (f), relating to average base period net income in case of increased earnings in last half of base period. However, in a proper case the principles underlying section 713 (e) (1) and 713 (f) may be taken into account if and to the extent that the application of such principles is reasonable and consistent with the conditions and limitations of section 722 and of such sections.

(2) If normal earnings are reconstructed for poor years within the base period of a taxpayer, the fair and just amount representing normal earnings determined with respect to such period cannot reasonably include above-normal earnings for other years in the base period. Consequently, if the constructive average base period net income involves a reconstruction of normal earnings for one or more taxable years in the base period, the taxpayer must be able to establish that the actual excess profits net income for other taxable years in the base period is not unusually large. Unusually large excess profits net income may occur either as the result of abnormally large gross income or as the result of abnormally low deductions. Thus if a manufacturing corporation, which was in existence throughout the base period, had a fire in 1937, which seriously interrupted production and caused an operating loss for such year but enjoyed exceptionally high earnings in 1938 as a result of production and sales which normally would have been enjoyed in 1937 and 1938, the excess profits net income for 1937 cannot be reconstructed upon the basis of normal earnings without also reconstructing excess profits net income for 1938 so as to eliminate the effects of the duplicated production and income for such year. Likewise, if in 1939 the taxpayer had exceptionally high earnings because of increased sales due primarily to a fire interrupting the production of its chief competitor, the income for 1939 must be adjusted to eliminate the effects of such unusual circumstance. However, no adjustment shall be made to eliminate income due to more favorable general business conditions.

Excess profits net income shall be considered unusually large in a taxable year in the base period only if, as the result of physical or economic circumstances unusual and peculiar in the case of the taxpayer, the income for such year is larger than it would have been if such circumstances had not occurred. Increased income due to circumstances which have affected business in general and which have caused an increase in the earnings of business in general, or due to circumstances which would not be considered unusual and peculiar in the experience of the taxpayer shall not be deemed to result in unusually large excess profits net income. If excess profits net income for a taxable year is determined to be unusually large, gross income and deductions shall be recomputed so as to remove the effect of the unusual circumstances in the computation of excess profits net income for such year.

(3) Except as otherwise provided, the constructive average base period net income shall be computed with regard to the principles in section 711 (b) (relating to excess profits net income for taxable years in the base period) applicable to the taxable year for which the constructive average base period net income is used. The rules provided by section 711 (b) (1) (H), (I), (J), and (K), relating to abnormal deductions and costs, may not be used as a matter of right in computing the constructive average base period net income. In a proper case, however, the principles underlying section 711 (b) (1) (H), (I), (J), and (K) may be taken into account if and to the extent that the application of such principles is reasonable and consistent with the conditions and limitations of section 722 and of such section.

(4) If the taxpayer has acquired the business of any other person (corporation, partnership, or individual) hereafter called "a component corporation" in a transaction which enables the taxpayer to compute its average base period net income under the provisions of Supplement A, the business of such component corporation shall be considered to be a part of the business of the taxpayer for the period for which the income of such component corporation is included in the computation of the average base period net income of the taxpayer under Supplement A. A taxpayer which has acquired, in a transaction which constitutes it an acquiring corporation under Supplement A, a component corporation for which a constructive average base period net income has been finally determined and has been used by such component in a taxable year prior to its acquisition, cannot as a matter of right use such constructive average base period net income in the determination of its average base period net income under Supplement A. The taxpayer as an acquiring corporation must establish, in accordance with the provisions of section 722 (e) (2), the amount which, in the light of such provisions, would constitute a fair and just amount representing normal earnings to be used as its constructive average base period net income. If the taxpayer has during the base period acquired substantially all the assets of another corporation in a transaction which does not constitute the taxpayer an acquiring corporation within the provisions of Supplement A, and after such transaction such other corporation ceases business, the business of such other corporation attributable to the assets acquired may be considered to be a part of the business of the taxpayer during the base period, to the extent to which it does not duplicate the business of the taxpayer otherwise carried on.

(5) If a taxpayer which, for the purposes of the income tax imposed by Chapter 1, computes its income from installment sales under the method provided by section 44 (a) elects to compute such income for excess profits tax purposes under Subchapter E of Chapter 2 upon the accrual basis pursuant to section 736 (a), any constructive average base period net income established with respect to such taxpayer shall be deter-

mined under the accounting methods underlying the computation of income from installment sales followed by the taxpayer in computing its income tax for the base period.

(6) If a taxpayer elects under the provisions of section 736 (b) to compute income from contracts the performance of which requires more than 12 months upon the percentage of completion method of accounting, any constructive average base period net income established with respect to such taxpayer shall be determined in accordance with the principles underlying the percentage of completion method of accounting. See § 29.42–4 (a) of this chapter.

(7) If an affiliated group of corporations makes a consolidated excess profits tax return under section 141 for a taxable year beginning after December 31, 1941, any constructive average base period net income must be established with respect to the group as a unit and no constructive average base period net income shall be established separately for any member of the group. If the members of an affiliated group for which a constructive average base period net income has been established are different during the taxable year from the members at the time such constructive average base period net income was established (because new members have been acquired by the group or because old members have ceased to remain members) or if one or more members of the group have become acquiring corporations of component corporations pursuant to Supplement A, the group may not as of right continue to use the constructive average base period net income previously established but must establish a new constructive average base period net income predicated upon the membership of the group for the taxable year for which relief is claimed. No constructive average base period net income determined with respect to any member of the group prior to the year for which the group makes a consolidated excess profits tax return shall be used by the group as a matter of right in computing its actual average base period net income. If a taxpayer ceases to be a member of an affiliated group which, during the time that such taxpayer was a member, made a consolidated excess profits tax return and used a constructive average base period net income in the computation of its excess profits tax, such taxpayer shall not use any portion of such constructive average base period net income in the computation of its separate excess profits tax or the excess profits tax of another affiliated group of which it becomes a member. Any constructive average base period net income to be used by such taxpayer or by such other group must be established solely with respect to such taxpayer or such group.

(8) For the purposes of section 722 and of § 35.722–3 (b) and (c), no exclusive definition of the concept "industry" can be constructed. In general an industry may be said to include a group of enterprises engaged in producing or marketing the same or similar products or services under analogous conditions which are essentially different from those encountered by other enterprises. The mere similarity of product and marketing methods, however, is not enough of itself to comprehend taxpayers satisfying such conditions within the same industry. Factors such as geographical location, character and location of markets, availability and character of raw material supply, and other conditions under which operations are carried on must be considered. Regard may be had to trade custom and practice in determining whether a group of enterprises constitutes an industry.

(9) The fact that the excess profits tax liability of a taxpayer, establishing eligibility for relief and a constructive average base period net income under section 722, is zero or is very small prior to the application of such section does not prevent the actual average base period net income from being an inadequate standard of normal earnings. Such a taxpayer is entitled to use the constructive average base period net income established under section 722 in the computation of its excess profits tax for all excess profits tax taxable years, and to compute its unused excess profits credit for any excess profits tax taxable year with respect to the excess profits credit based upon such constructive average base period net income. However, in the case of a taxpayer which is deemed to have commenced business or to have changed the character of its business two years prior to the actual event, in the case of a taxpayer consummating a change in the capacity for production or operation in a taxable year beginning after December 31, 1939, as a result of a course of action to which it was committed prior to January 1, 1940, in the case of a taxpayer which prior to May 31, 1941, acquired from a competitor engaged in the dissemination of information through the public press substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, or in the case of a taxpayer which commenced business after December 31, 1939, the constructive average base period net income might vary from one excess profits tax taxable year to another. As to the determination of the constructive average base period net income in such cases, see §§ 35.722–3 (d) and 35.722–4.

(c) *Excess profits credit based on constructive average base period net income.* For any excess profits tax taxable year for which a constructive average base period net income has been determined under the provisions of section 722 and of this section, the excess profits credit based on income shall be an amount equal to:

(1) 95 percent of the constructive average base period net income determined under section 722;

(2) Plus 8 percent of the net capital addition defined in section 713 (g) computed with regard to the provisions of section 722 (c); or

(3) Minus 6 percent of the net capital reduction defined in section 713 (g) computed with regard to the provisions of section 722 (c).

(d) *Normal output and normal unit profit in case of producers of minerals or timber.* Nontaxable income from exempt excess output of mines or timber blocks determined under section 735 (relating to nontaxable income from certain mining and timber operations) may be excluded under section 711 (a) (1) (I) or section 711 (a) (2) (K) from the excess profits net income of a taxpayer for which there is established under section 722 a constructive average base period net income. For the purposes of computing nontaxable income from exempt excess output under section 735 in such a case, there shall be determined with respect to each mineral property as defined in section 735 (a) (6), or timber block as defined in section 735 (a) (8), in which an economic interest is owned by the taxpayer, a fair and just amount to be used as the normal output as defined in section 735 (a) (5), and with respect to such mineral property, a fair and just amount to be used as the normal unit profit as defined in section 735 (a) (9). However, no amounts representing fair and just normal output or normal unit profit for such base period shall be established for any mineral property or timber block unless the constructive average base period net income is predicated in whole or in part upon normal earnings attributable directly to such mineral property or timber block, unless such mineral property or timber block was in operation for at least six months during the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939, of the person owning the mineral property or timber block (whether or not the taxpayer), and in the case of a timber block, unless such timber block was in existence and was acquired by the taxpayer prior to January 1, 1942. A normal output and a normal unit profit may be established for a mineral property or a timber block in which an economic interest is owned by the taxpayer despite the fact that such taxpayer came into existence after December 31, 1939, if such mineral property or timber block meets the requirements provided in the preceding sentence.

§ 35.722–3 *Determination of excessive and discriminatory tax; taxpayer entitled to excess profits credit based on income.* The excess profits tax, computed without regard to the provisions of section 722, for any taxable year shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713 (or pursuant to Supplement A if the taxpayer is an acquiring corporation under Supplement A) if its actual average base period net income is an inadequate standard of normal earnings for one or more of the following reasons:

(a) *Interruption or diminution of normal production, output, or operation in the base period.* If the taxpayer establishes that in one or more taxable years in its base period normal production, output, or operation was interrupted

or diminished because of the occurrence either immediately prior to, or during the base period, of events unusual and peculiar in the experience of the taxpayer, the average base period net income shall be considered to be an inadequate standard of normal earnings. Activities comprised within the meaning of production, output, or operation include the rendering of services in those cases in which corporations render services rather than manufacture or market tangible products, as for example advertising agencies, brokerage concerns, purchasing agents, etc. Normal production, output, or operation means the level of production, output, or operation which would have been reached by the business of the taxpayer had the unusual and peculiar events not occurred.

Not every interruption or diminution of normal production, output, or operation in the base period may furnish the basis of a claim for relief under section 722. The interruption or diminution must be a direct result of events unusual and peculiar in the experience of the taxpayer, and must occur in or immediately prior to the base period. A direct result of an unusual or peculiar event is a result which would occur as a normal consequence or effect of the event and one to which the event bears a casual relationship. The diminution or interruption of normal production, output, or operation may occur not only in the year in which such event occurs but may result in a later year directly affected by such event.

An event is deemed to occur immediately prior to the base period if under normal circumstances the effect of such event would not be fully manifested until a year in the base period and such effect is directly related to such occurrence. An event is unusual and peculiar in the experience of the taxpayer if its occurrence is not ordinarily encountered in such experience. The fact that such event unusual in the case of the taxpayer is also unusual in the case of other taxpayers, as in the case of a flood in a particular locality, is no bar to a claim for relief under section 722 (b) (1). If an event is unusual in the course of normal business experience in general but regular in the case of the taxpayer, such event is not unusual and peculiar in the experience of the taxpayer. Thus, if a corporation is engaged in felling and transporting logs and timber, and if its annual operations are interrupted by spring floods occasioned by thaws and rains, such events are not unusual and peculiar in the experience of the taxpayer. Unusual and peculiar events contemplated in section 722 (b) (1) consist primarily of physicial rather than economic events or circumstances. Except as otherwise described in this paragraph, such events would include floods, fires, explosions, strikes, and other such exceptional and uncommon circumstances hindering production, output, or operation; such events would not include economic maladjustments such as higher prices of materials, labor, capital, or any other agent of production, unusually low selling price of the product of the taxpayer, or unusually low physical volume of sales owing to low demand for such product or for the output of the taxpayer. However, a diminution in the taxpayer's production caused by a low demand for the product of the taxpayer resulting from the effects of war conditions in the country in which the taxpayer sold a substantial portion of its products may be an event which might form the basis of a claim for relief under section 722 (b) (1).

The taxpayer's normal production, output, or operation for those years in which interruption or diminution has been established may be determined by reference to its average production, output, or operation with respect to products or services of the same class. This determination may be made in the light of the experience of the taxpayer prior to its first excess profits tax taxable year (but not after May 31, 1940), or in the light of the experience of a comparable competitor or of an industry of which the taxpayer is a member, engaged in manufacturing or selling the same products or rendering the same services. No particular years or specific number of years in such experience need be selected in establishing normal production, output, or operation. However, normal earnings reconstructed for one or more taxable years in the base period or for the base period as a whole on account of an interruption or diminution in production, output, or operation, must be determined in the light of business conditions prevailing during such period. Among the material factors to be considered are general business conditions, business conditions together with the taxpayer's competitive position in an industry of which the taxpayer is a member, and demand for the products or services of a class produced or rendered by the taxpayer. The cost of materials, labor, capital, or any other agent of production, the selling price of the product or the service, the physical volume of sales resulting from the demand for such products or services during the base period are also factors to be taken into account.

Thus, assume that, except for the year 1938 in which the taxpayer experienced an explosion in its plant which interrupted production and caused an operating loss for the year, the base period represented a period of normal earnings for the taxpayer. Such period also represented a period of normal earnings for the industry of which the taxpayer is a member. In the year 1938 the demand for the product manufactured by the industry of which the taxpayer is a member was 20 percent below the demand for such product for the average of the other years in the base period. The taxpayer's normal production and normal earnings for 1938 should be reconstructed upon the basis of the actual demand in that year, rather than upon the basis of the demand for the remaining years in the base period.

(b) *Business depression in base period on account of temporary economic circumstances.* If the taxpayer establishes that its business was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which the taxpayer was a member was depressed by reason of temporary economic circumstances unusual in the case of such industry, the average base period net income of the taxpayer shall be considered to be an inadequate standard of normal earnings. For the purposes of this paragraph a business shall be considered to be depressed if it realized low earnings or operating losses which resulted from such factors as a low volume of output of products or services, from a low volume of sales, from high manuacturing costs, from low sales price, or from a combination of such factors.

Only those economic circumstances which were temporary in the sense that they had little perceptible effect upon the long run prospects of a business, and which affected the taxpayer alone or an industry of which it was a member as distinguished from those economic events which were of a chronic or continuing character or which affected business in general, may furnish a basis for a claim for relief under section 722 (b) (2). An economic circumstance is temporary depending upon the character and nature of such circumstances rather than upon the mere length of time of its existence. Thus the income of a declining business or industry which was depressed throughout the base period because of economic conditions of a chronic and continuing character which may be expected to depress the earnings of such business for an indefinite period is not an inadequate standard of normal earnings under section 722 (b) (2). For example, a traction company the earnings of which had been steadily reduced over a decade by increasing competition with motor trucks and by the use of private passenger vehicles might not be considered to suffer business depression by reason of temporary and unusual economic circumstances. Higher income resulting from increased patronage due to wartime restrictions upon the use of alternative methods of transportation should reasonably be regarded as excess profits. Low earnings are entirely normal in the case of such a chronically depressed taxpayer and are not rendered subnormal merely because an increased level of profits resulting from the effect of war conditions occurs during excess profits tax taxable years.

High costs of production because of high costs of material, labor, capital, or other elements of production, low selling price of the finished product, low volume of sales due to a low demand for such product or the taxpayer's output, or other ordinary economic hazards to which business in general is subject and which have the effect temporarily of depressing income are ordinarily not sufficiently unusual economic circumstances to constitute income an inadequate standard of normal earnings under section 722 (b) (2). Such circumstances are to be expected during any period of normal earnings and are presumed to have been offset by counterbalancing economic circumstances causing higher than average profits in other years in the base period.

Consequently, the presence of unfavorable economic factors during the base period years of a taxpayer is not unusual when the presence of such factors is usual in the case of an industry of which the taxpayer is a member, or if such industry is depressed, in the case of business in general for such years. Nevertheless unusual and temporary economic circumstances reflected in one or more of such factors may depress the business of the taxpayer substantially beyond the extent to which other members of an industry of which the taxpayer is a member are affected, or may depress the industry (including the taxpayer) substantially beyond the extent to which other industries are affected. In such case the presence of such circumstances is an adequate reason for establishing that actual average base period net income is an inadequate standard of normal earnings. However, the mere fact that the business of the taxpayer or of an industry of which it is a member, as the case may be, fluctuates widely under the impact of economic events or is operated at a lower level of earnings than other members of such industry or other industries, as the case may be, and thus is depressed to a greater degree by unfavorable economic conditions than such other members or industries does not of itself indicate that average base period net income is an inadequate standard of normal earnings.

As in the case of unusual and peculiar physical events interrupting or diminishing production, output, or operation (see § 35.722–3 (a)), a temporary economic circumstance is unusual in the case of a taxpayer or of an industry if its occurrence is not ordinarily encountered in the experience of such taxpayer or industry. However, a temporary economic circumstance which is usual in the case of the taxpayer is not rendered unusual because such circumstance is unusual in the case of an industry of which the taxpayer is a member or in the course of normal business experience in general. As to the definition of an "industry", see § 35.722–2 (b) (8).

An example illustrating § 35.722–3 (b) might be a taxpayer which for a long period of years conducted business with one customer which it lost during the base period because such customer decided to manufacture for itself the product it had formerly bought from the taxpayer. The taxpayer would be compelled to develop a new market. The average earnings of the taxpayer for the period of time during which the taxpayer was engaged in obtaining new customers would not represent an adequate standard of its normal earnings and would be sufficient cause for the establishment of a constructive average base period net income under section 722.

An example in which temporary economic events caused business depression during the base period of an industry of which the taxpayer was a member would be an industry the members of which (including the taxpayer) were engaged in a ruinous price war during several of the base period years. As a result of sales below cost in such years, the members of the industry sustained severe losses; when the price war was ended, the members again realized normal average earnings. The business of the taxpayer in such case would be depressed during the base period because of the fact that an industry of which the taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry and the average base period net income of such taxpayer would be an inadequate standard of normal earnings.

If the temporary economic circumstances causing the taxpayer to be depressed in the base period did not affect an industry of which the taxpayer was a member, the constructive average base period net income of the taxpayer may be established in the same manner as is prescribed in the case of a taxpayer the base period production, output, or operation of which was interrupted or diminished by events unusual and peculiar in its experience. See § 35.722–3 (a). However, since the actual economic conditions existing in the years for which depression is claimed are those which caused such depression, normal earnings should be reconstructed not upon the basis of the actual economic factors affecting the taxpayer's production, costs, sales, and profits in such years but upon the basis of such factors as existed in such years in the case of the industry of which the taxpayer was a member. Relationships existing between the taxpayer's production, costs, sales, and profits and the average production, costs, sales, and profits of the industry or other members of the industry, in other periods determined to represent periods of normal earnings for the taxpayer and the industry, or other members of the industry, may be utilized in determining the taxpayer's production, costs, sales, and profits for the base period. Depending upon the particular circumstances in the taxpayer's case normal earnings might be reconstructed for each base period year in which the taxpayer was depressed, or a constructive average base period net income might be determined for the base period as a whole without a reconstruction for separate years.

If the taxpayer was depressed in the base period because an industry of which it was a member was depressed by reason of temporary economic circumstances unusual in the case of such industry, the constructive average base period net income of the taxpayer might be determined by reference to a prior period in the experience of the taxpayer, or of an industry in which it is a member, which is established to be a period of normal earnings, or possibly by reference to the base period experience of comparable taxpayers or industries. Since actual economic conditions prevailing in the base period of the taxpayer were those which had the effect of causing depression in the industry of which the taxpayer was a member, such conditions should not form the basis upon which normal earnings of the taxpayer are reconstructed if such reconstruction is made for any of the years in the base period of the taxpayer or for such period in its entirety. In such case, relationships established between the economic condition present in the case of the taxpayer during other periods and such conditions in the case of comparable taxpayers or industries may be used in determining the taxpayer's production, costs, sales, and profits which would have been realized had the temporary and unusual economic circumstances not affected the industry of which it was a member.

(c) *Business depression in base period because of variant profits cycle or sporadic and inadequately represented profits periods.* If the taxpayer establishes that its business was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member subjecting such taxpayer either to a profits cycle which differs materially in length and amplitude from the general business cycle or to sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period, the average base period net income of the taxpayer shall be considered to be an inadequate standard of normal earnings. To come within the provisions of section 722 (b) (3) and this paragraph, it must be shown that the business of the taxpayer was depressed in the base period as a consequence of circumstances which are ordinary and usual in the case of an industry of which the taxpayer is a member; such business depression may not result from extraordinary and unusual events such as are necessary to invoke the provisions of section 722 (b) (2) and § 35.722–3 (b). Furthermore, the conditions producing the unusual profits cycle or the sporadic profits of the taxpayer must be shown to have prevailed generally throughout the past history of the industry and not to be peculiar to the base period alone. The ordinary circumstances existing in the case of the industry of which the taxpayer is a member and which produce business depression in the case of the taxpayer must also be established by the taxpayer to have produced business depression with respect to the industry generally during the base period. As to the definition of "industry" see § 35.722–2 (b) (8).

(1) *Unusual profits cycle.* No categorical definition or description can be given to the concept of the general business cycle. The term does not refer to any particular business index prepared by any public or private financial, economic, or statistical organization, or combination of such indices. A taxpayer does not establish a claim for relief under section 722 (b) (3) (A) merely by comparing its own profits cycle, or the profits cycle of an industry of which it is a member, with one or more general business indices prepared by any public or private financial, economic, or statistical organization, and by showing a variance between its own profits cycle and such other general business indices.

On a national industry-wide basis, the four years beginning January 1, 1936, and ending December 31, 1939, represent a period of normal average earnings in the experience of business in general. If, due to conditions entirely normal in the experience of an industry of which the

taxpayer was a member, such period was not correspondingly a time of normal average earnings in the case of the industry and of the taxpayer in the light of the prior experience of such industry and taxpayer, the profits cycle of the taxpayer may be considered to be different from the general profits cycle.

The profits cycle of a taxpayer will be deemed to differ in length and amplitude from the general business cycle if its period of normal profits has not occurred during the base period but at some prior time entirely without the base period, or partly without and partly within such period. It is not necessary that the length of the taxpayer's profits cycle be longer or shorter than four years nor is it necessary that the crests and troughs of such profits cycle vary from the level of high and low profits of the general business cycle. Only in case the normal average earnings of the taxpayer and an industry of which it is a member are substantially greater than the average profits earned during the excess profits tax base period will the profits cycle of a taxpayer be considered to differ materially from the general business cycle.

The mere fact that the earnings of the taxpayer and an industry of which it was a member are not as high during the base period as they were during some prior period in the experience of such taxpayer or such industry does not necessarily mean that normal average earnings are greater than earnings during the base period. Normal average earnings are average earnings for all periods of normal earnings in the experience of such taxpayer or such industry. It is inevitable that some periods of normal earnings should be higher or lower than other such periods. Consequently the fact that the earnings of the taxpayer and of an industry of which it is a member are slightly lower than the level of normal average earnings is not of itself an indication that the profits cycle of the taxpayer or the industry varies materially from the general business cycle.

A taxpayer which claims to be a member of an industry in which conditions prevail which subject the taxpayer to a profits cycle differing materially from the general business cycle must establish that the business experience both of itself and of such industry is susceptible of segregation into a cyclical pattern. Types of industries, the business cycles of which may not necessarily coincide with the general business cycle, are industries connected with the construction industry. It is well established that over the past three decades there has been a building cycle which generally has embraced two or more of the general cycles of business profits. If the base period embraced only the subnormal years of the profits cycle of a branch of the building industry, the members thereof may be able to establish that their average base period net income does not represent an adequate standard of normal profits. If, however, the profits cycle of such branch of the building industry and of the taxpayer in a particular locality in which the operations of such branch and of the taxpayer were encompassed followed the pattern of the general business cycle in the base period so that such period represented a period of average normal profits for the taxpayer, no basis would exist for a claim for relief under section 722 (b) (3) (A).

The constructive average base period net income of a taxpayer which was depressed in the base period on account of a variant profits cycle might be determined by reference to one or more prior periods in the experience of the taxpayer or of the industry of which it was a member which represents a period of normal earnings properly attributable to such taxpayer. These periods need be of no specified duration except that they should not be less than three years. If any one such period is used it should be established that with respect to the taxpayer and the industry of which it was a member, such period bears the same relationship to the profits cycle of the taxpayer and the industry which the base period (representing a period of normal earnings of business in general) bears to the general business cycle. In case no such prior periods are available, if proper relationships based upon comparative profit and loss statements and balance sheets can be established, the constructive average base period net income might be determined by reference to the average base period net income of comparable taxpayers or industries for which the base period represents a period of normal earnings. In such case, actual economic factors of production, costs, demand, sales, and profits experienced by the taxpayer during the base period should not generally serve as a limitation upon any normal earnings reconstructed for the taxpayer for the base period.

(2) *Sporadic profits inadequately represented in the base period.* The characteristic distinguishing the type of case described in section 722 (b) (3) (B) from that in section 722 (b) (3) (A) is that in the latter case the taxpayer has an earnings experience which can be segregated into definite cycles, whereas in the former case (the type of case described in this paragraph) no such cyclical segregation can be made. In case the taxpayer is subjected to intermittent periods of high production and profits, the prosperous years of the taxpayer will occur at irregular and unpredictable intervals, and may depend upon fortuitous combinations of advantageous circumstances, as for example the juxtaposition of a good crop and a good market. If the base period of the taxpayer does not include these prosperous years, its earnings during such period will not be an adequate measurement of average normal earnings.

Proof that a year of high production and profits did not occur during the base period is not of itself sufficient to establish that the base period did not represent a period of normal earnings. The actual average base period net income computed under section 713 (d) may approximate either the average earnings of periods of normal earnings, which include years of very high profits as well as years of low profits, or the average earnings for the entire experience of the taxpayer. Consequently it must be established not only that the base period did not include one or more years of high profits irregularly experienced by the taxpayer but also that the level of earnings for periods of average normal earnings which include such years or the level of earnings for the entire period in which the taxpayer was in existence is substantially higher than the level of earnings during the base period. Since the concept of normal earnings does not contemplate a fixed and inflexible amount but envisions a level of earnings which represents normal earning capacity of a business, the mere fact that actual average base period net income is less than an amount which might be determined by reference to some period claimed to represent normal earnings or by reference to an average of earnings over the entire economic life of a business does not establish that such average base period net income is an inadequate standard of normal earnings.

A taxpayer which claims to be a member of an industry in which conditions prevail which subject the taxpayer to sporadic and intermittent periods of high production and profits must establish that business depression was encountered during the base period because of such conditions. It must also establish that such conditions were not peculiar to it alone in the base period but were also present in the case of such industry.

A taxpayer does not establish eligibility for relief under section 722 (b) (3) (B) merely by showing that annual periods of high profits have occurred irregularly in the past experience of the taxpayer. Such periods of high earnings may have resulted from windfall profits or from unusual circumstances befalling the taxpayer, or an industry of which it is a member, and not as the result of normal conditions under which the taxpayer's usual operations are carried on. Only in case high earnings which have occurred in prior years are directly attributable to factors normal in the case of the taxpayer and of an industry of which it is a member, may such high periods of production and profits be considered grounds for relief under section 722 (b) (3) (B).

Depending upon actual proof, a possible example of an industry operating under conditions which subject its members to sporadic and intermittent periods of high production and profits might be an industry engaged in the preparation and canning of fruit. Profits would be dependent upon the size of the pack and the market obtainable. Suppose that the records of a taxpayer in such industry indicate that ordinarily in one out of every three years the earnings were substantially in excess of the average of the other three years, and that no prosperous years occurred in the base period, as follows:

Net income (in thousands of dollars)

1926	50	1933	25
1927	10	1934	20
1928	15	1935	48
1929	55	1936	15
1930	12	1937	23
1931	45	1938	13
1932	18	1939	10

If the records of the industry of which the taxpayer is a member show a similar pattern, the average base period net income of such concern would not be deemed to be an adequate standard of normal earnings and such taxpayer would be entitled to relief under section 722 (b) (3) (B).

The constructive average base period net income of a taxpayer depressed during the base period on account of the failure of such period to reflect one or more years of high profits sporadically enjoyed by the taxpayer might be determined in the same manner as in the case of a taxpayer with a variant profits cycle. See § 35.722–3 (c) (1). In a proper case a standard of normal earnings might fairly be determined as an average of earnings of the business in its experience prior to the beginning of its first excess profits tax taxable year (but not after May 31, 1940), and a reasonable determinations of excess profits could be made as the excess of the profits during a current excess profits tax taxable year over such standard.

(d) *Commencement or change in character of business.* If the taxpayer has commenced business or has changed the character of its business either during or immediately prior to the base period, and if the taxpayer establishes that its average base period net income does not reflect the normal operation for the entire base period of a business so commenced or changed in character the average base period net income shall be considered to be an inadequate standard of normal earnings.

No arbitrary temporal limitations can be provided to circumscribe the concept of "immediately prior to the base period" for the purposes of section 722 (b) (4) in the case of a business commenced or changed in character at such time. Nor does the fact that a taxpayer has commenced business or changed the character of its business within one or two years prior to the base period necessarily establish eligibility for relief under section 722 (b) (4). Generally, business experiences a time lag between the time that new operations are commenced, reflecting either the starting of a new business or of a business essentially different in character from an old business, and the attainment of a normal earning level. If all or a portion of this time lag occurs during the base period, the earnings during such period cannot be said to represent normal average earnings.

Generally, the commencement of business or the change in character of a business will be deemed to have occurred immediately prior to the base period if under normal conditions the normal earning level of a business so commenced or changed would not be realized until some time during the base period and would be principally and directly related to such commencement or change. However, if a taxpayer, which has commenced business immediately prior to the base period, has reached its level of normal operations prior to such period, but has sustained a loss in its first base period year because of the occurrence of an unusual event or circumstance, such as a flood interrupting production, the average base period net income will not be considered to be an inadequate standard of normal earnings because the taxpayer has commenced business immediately prior to the base period. Any relief sought by such a taxpayer should be based upon interruption of production under section 722 (b) (1) and § 35.722–3 (a).

The following examples are illustrations of the provisions of this paragraph: Corporation A, which makes its returns on a calendar year basis, and which until 1934 manufactured snuff at a loss, in that year changed to the manufature of cigars. Due to normal difficulties in establishing trade connections and in establishing its product, it did not realize normal profits until 1938. Such corporation is deemed to have changed the character of its business immediately prior to the base period. Corporation B, which makes its returns on the calendar year basis, converted its business in 1934 from the manufacture of general textiles to the manufacture of automobile upholstery. It immediately realized a level of earnings which were deemed to be reasonable for such business and enjoyed such earnings until 1938. In that year it made a profitable connection with a large automobile manufacturer, and as a result realized larger profits. The fact of such large profits due to this connection is not principally and directly attributable to the change in the character of the business in 1934, and such fact is not a normal and inevitable result of such change. Consequently the change in the character of the business in 1934 is not considered to have occurred immediately prior to the base period for the purposes of section 722 (b) (4).

If the business of a taxpayer which was commenced or changed in character either immediately prior to or during the base period was growing and expanding so that by the end of the base period it did not reach the earning level which it would have attained had the business been commenced or changed in character two years prior to the time of the actual event, the taxpayer shall be deemed to have commenced business or changed the character of its business at such earlier time. In order to establish that its actual average base period net income is an inadequate standard of normal earnings, the taxpayer shall establish that the actual average base period net income does not reflect the normal operation for the entire base period of a business commenced or changed in character at such earlier date. In determining whether the business of the taxpayer was growing or expanding by the end of the base period, consideration may be given to the taxpayer's actual business experience during and immediately prior to the base period, including its rate of growth, to a comparison of the taxpayer's experience and the experience for a comparable period of other members of an industry of which the taxpayer is a member, to the experience and rate of growth of such members after the commencement or change in character of their business, and to the future prospects of the business of the taxpayer under normal conditions reasonably ascertainable at the end of the base period. Events occurring or existing after December 31, 1939, may not be considered in determining whether the taxpayer was growing by the end of the base period, or if so, to the extent thereof.

An example illustrating the preceding paragraph would be a corporation which was organized in 1938 and started the development of a delivery route to sell food products. In 1938, it had a net loss; in 1939, a moderate profit. Its record of earnings is as follows:

Net income (in thousands of dollars)

1938	−5
1939 (first quarter)	−1
1939 (second quarter)	2
1939 (third quarter)	4
1939 (fourth quarter)	7

Its steady growth together with other factors indicates that if it had started business two years earlier its earning level at the end of the base period would have been considerably higher. Such taxpayer shall be deemed to have started business in 1936, and its average base period net income would not be considered an adequate reflection of normal operations for the entire base period of the type of business which would have resulted at the end of the base period if the taxpayer had started business in 1936.

Another example would be a taxpayer which immediately prior to and during the base period was engaged in research and development of an American raw material for the manufacture of a product not theretofore practicable of manufacture in the United States. In early 1938 a process was perfected for such manufacture. In that year, the taxpayer entered into sales contracts, commenced a program of building plant and equipment (ultimately completed in 1941), and began to supply its customers in September, 1939. It operated with low invested capital and its earnings did not reach by the end of the base period the level which would have been reached if the taxpayer had commenced business two years earlier. In such case the average base period net income will be considered to be an inadequate standard of normal earnings, and the taxpayer will be deemed to have commenced business two years prior to the actual commencement.

For the purposes of section 722 (b) (4), normal operations refers to normal operations throughout the entire base period of the business commenced or to which such business was changed immediately prior to or during the base period, and to the normal earnings reconstructed on the basis of such normal operations for such entire period. The taxpayer may have commenced business or changed the character of its business after the beginning of the base period; such commencement or change although considered to have been effected two years prior to the actual event might still occur after the beginning of the base period. Neither fact shall prevent the reconstruction of normal earnings for the entire base period, including the time prior to the date of the actual commence-

ment or change or to the date upon which the commencement or change is considered to have occurred.

If the business of the taxpayer has reached by the end of the base period the earning level it would have reached had it been commenced or changed in character two years prior to such event, normal earnings for the entire base period shall be reconstructed upon the basis of the level of normal operations actually attained during the base period and upon the basis of the character, nature, and size of the business actually developed during the base period. If the business of the taxpayer is considered to have been commenced or changed in character two years prior to such event, normal earnings for the entire base period shall be based upon the level of normal operations, and upon the character, nature, and size of the business which would have been developed by the end of the base period if the business had been commenced or changed at such earlier date.

If a business which was commenced or changed in character either during or immediately prior to the base period did not reach, by the end of the base period, the earning level it would have reached had it been commenced or changed in character two years earlier, the earning level which it would have reached had such events occurred at such an earlier date will be dependent upon reconstructed, as opposed to actual production, costs, demand, sales, and selling prices. If may not be possible to reconstruct demand, sales, and selling prices based upon actual economic conditions existing within the framework of the base period. In certain cases actual demand, sales, and selling prices might not represent reasonable limitations upon the earning level which the taxpayer would have reached had its business been commenced or changed in character two years prior to the actual occurrence. Moreover the fact that a business is deemed to have been commenced or changed two years earlier implies the existence of conditions not necessarily present in the period for which reconstruction is being made. Consequently, in proper cases, demand, sales, and selling prices may be established upon the basis of certain assumptions not inconsistent with the fact that the taxpayer is considered to have commenced business or changed the character of its business two years prior to the actual commencement or change and not inconsistent with the experience of similar taxpayers which have reached a level of normal earnings, or of an industry of which the taxpayer is a member, which might furnish an indication of economic factors to be encountered by an expanding business.

Although actual economic factors influencing the taxpayer's earnings for the period prior to its attainment of normal operations may not reflect the results of such operations and consequently might not furnish adequate criteria for determining the normal earnings for such period, regard might be had to such factors to the extent that they might be determinants in establishing the taxpayer's earning capacity. Thus, if the taxpayer's business is a continuation of a preexisting business enterprise, regard might be had to the experience and earning capacity of such enterprise in order to ascertain normal earnings to be attributed to the taxpayer. Likewise, if a corporation is reorganized in the base period into two new corporations, the excess profits net income of each of the new corporations for the taxable years in the base period in which each was not in existence may be determined from that part of the business of the original corporation operated by each of the new corporations and that part of the excess profits net income of the original corporation attributable to such part of the business.

If the business of the taxpayer, deemed to have been commenced or changed in character two years prior to such event, has not reached by the end of the base period its level of normal operations and of normal earnings because of the interruption or diminution of production, output, or operation on account of events unusual and peculiar in the experience of the taxpayer (section 722 (b) (1)), or because of adverse temporary economic circumstances unusual in the case of the taxpayer or an industry of which it was a member (section 722 (b) (2)), or because the taxpayer was a member of an industry in which conditions prevailed which would subject the taxpayer to a variant profits cycle or to sporadic and intermittent periods of high production and profits which are not represented in the base period (section 722 (b) (3)), or because of other factors adversely affecting the business of the taxpayer in the base period (section 722 (b) (5)), the principles pursuant to which relief is determined in such cases shall be taken into account in determining the normal operations and normal earnings of the taxpayer. Thus, a taxpayer which was organized and commenced business during the base period might be a member of an industry in which conditions prevailing in such industry subjected its members to a profits cycle materially different from the general business cycle. If the base period represented the trough in such cycle and the average base period net income of the members of the industry represented an inadequate standard of normal earnings, the normal operations and normal earnings of the taxpayer might be determined by reference to one or more other periods in the experience of the industry. Relationships existing between the taxpayer's operations in the base period and the operations of other members of the industry, or of the industry as a whole, might be taken into account. See § 35.722–3 (a).

The fact that income for the entire base period is to be reconstructed upon the basis of the level of normal operations actually attained during the base period or upon the basis of the level of normal operations which would have been reached had the business been commenced or changed two years earlier, does not necessarily mean that the highest level of earnings actually or constructively reached during the base period is to be ascribed to the entire base period. The earning level of business usually is fluctuating rather than constant. Normal earnings to be attributed to the taxpayer for the base period must follow such pattern. In determining such normal earnings regard may be had to the earnings cycle during the base period of other taxpayers engaged in similar businesses, of other members of an industry of which the taxpayer was a member, of such industry as a whole, and to relationships existing between the taxpayer's production, costs, sales, and profits during its years of normal operations and similar factors in the case of such other taxpayers or industry.

Events or conditions occurring after December 31, 1939, may not be taken into account in determining the constructive average base period net income of a taxpayer which during the base period has commenced business or changed the character of its business. Consequently, the level of normal operations which would have been reached by a taxpayer which is considered to have commenced business or to have changed the character of its business two years prior to the actual event shall not be determined by attributing to the base period the results of the taxpayer's operations for its first two excess profits tax taxable years beginning after December 31, 1939, or for any period of time after such date.

Since the amount of normal earnings in the case of a taxpayer which is considered to have commenced business or changed the character of its business two years prior to the actual event is based upon a reconstructed business experience which has been lengthened two years, such amount may exceed the actual earnings realized by the taxpayer during its first or second excess profits tax taxable year. Consequently, the reconstructed normal earnings which would be used as the constructive average base period net income after the second excess profits tax taxable year may not constitute a fair and just amount to be used for the purposes of the excess profits tax for the first or second excess profits tax taxable year. Therefore, in determining the constructive average base period net income to be used in computing the excess profits tax or the unused excess profits credit for the first or second excess profits tax taxable year, the fair and just amount representing normal earnings should be based upon the actual earning capacity which, as of the end of its base period, the taxpayer could reasonably have expected to reach under normal conditions during such first or second excess profits tax taxable year. If the excess profits net income for the taxpayer's first or second excess profits tax taxable year reflects an earning capacity greater than that reasonably established for such year, the amount by which such excess profits net income exceeds the excess profits credit based upon constructive average base period net income represents adjusted excess profits net income subject to excess profits tax. If the excess profits net income for such first or second taxable year is less than the excess profits credit

based upon the constructive average base period net income, the difference is the unused excess profits credit for such year under section 710 (c). See § 35.710–3.

A change in the character of the business for the purposes of section 722 (b) (4) must be substantial in that the nature of the operations of the business affected by the change is regarded as being essentially different after the change from the nature of such operations prior to the change. No change which businesses in general are accustomed to make in the course of usual or routine operations shall be considered a change in the character of the business for the purposes of section 722 (b) (4). Trade custom and practice may be taken into account in determining whether an essential difference in the character of the business has occurred. A change in the character of the business, to be considered substantial, must be reflected in an increased level of earnings which is directly attributable to such change. If such increased level of earnings is not actually realized in the base period, the taxpayer is not precluded from establishing a change in the character of the business provided it can establish that such increased level would have been attained in the base period but was hindered or delayed by unusual and peculiar events or economic circumstances. Such proof may not take into account any increase in earnings after December 31, 1939, as indicative of the fact that a change in the character of the business was productive of increased earnings.

A change in the character of the business includes changes resulting from the following activities:

(1) A change in the operation or management of the business. The introduction of new or substantially different processes of manufacturing or of new or substantially different methods of distribution would constitute a change in the operation of a business; the hiring of new key managing personnel or the adoption of materially new basic management policies by the old management resulting in drastic changes from old policies would constitute a change in the operation or management of the business. However, ordinary technological improvements developed in the course of routine business operations or changes in operating or supervisory personnel normally experienced by business in general and having no effect upon basic business policies would not be considered a change in the operation or management of the business.

Examples of a change in operation or management might be the following:

Corporation A was reorganized in 1936, and the new directors and officers initiated drastic changes in management, sales, and production policies which were not reflected in the corporation's earnings until 1939; a change in management would be deemed to have occurred. In 1937, Corporation B engaged in coal mining converted from a system of hand loading, under which it had lost money, to mechanized loading which reduced operating costs and resulted in profits; a change in operations has occurred. Likewise, Corporation C, which prior to 1938 marketed its product from door to door, in such year changed such sales methods to direct sales to retailers and thereafter realized profits; it would be deemed to have effectuated a change in operations. Corporation D experienced a severe reduction in the volume of its business due in part to economic conditions but principally to financial mismanagement. Early in 1939 new management was provided, new financial policies were adopted, and the volume of business and of earnings was greatly increased as a result thereof; Corporation D is deemed to have made a change in the management of its business.

(2) A difference in the products or services furnished. A product or service is different from another product or service if the trade custom or practice treats it as a product or service of a different class. A mere improvement in the product or service does not constitute a difference in the product or service. For example, a corporation in one year of its base period was engaged in both the radio broadcasting business and the department store business, and on January 1, 1940, was engaged only in the radio broadcasting business, the department store business having been discontinued. The corporation is deemed to have changed the character of its business. The same is true of a radio station which for three years in its base period was operated by a seed and nursery company. Beginning in 1939, the radio station was operated strictly as a commercial venture, the seed and nursery business having been discontinued. Another taxpayer manufactured and sold a variety of products, some under patents it had developed. During the base period it engaged in extensive research, developed new products, perfected and obtained a patent, and employed new marketing methods, enabling it to sell a leading product never before sold in the new markets. A difference in the products furnished is deemed to have resulted.

(3) A difference in the capacity for production or operation. A difference in the capacity for production or operation exists not only where new facilities have been acquired or old facilities enlarged, but also where latent productive or operative equipment is utilized and where newly developed techniques adopted with respect to existing facilities expand the productive or operating capacity of such facilities. Also included are cases where liquid working capital has been increased admitting of an enlarged scope of operations. A radio broadcasting station increased its power during the base period, necessitating changes and expansion of the physical property of the station, and thus enlarged the area it served. The station was thereby enabled to increase its volume of advertising and advertising rates. Such radio station is deemed to have effected a change in its capacity for production or operation. A taxpayer, in addition to its regular business of manufacturing dental equipment, in 1937 entered the field of manufacture of custom-built precision parts and instruments for the aviation industry, using surplus capacity for the purpose. Such activities would be considered to result in a change in the capacity for production and operation and the normal expansion, including expansion of the line of products which it would have experienced in this new field had it entered such field two years earlier, would be considered.

(4) A difference in the ratio of nonborrowed capital to total capital. As used in this paragraph, total capital is the sum of the average equity invested capital and the average borrowed capital for the taxable year. If a taxpayer operated during the base period in whole or in part on borrowed capital, the interest paid or accrued on such capital would be a deduction in computing average base period net income. If during the base period borrowed capital was reduced so that at the end of its base period the interest deduction was reduced, deductions for interest during the base period would be greater than such deductions during the excess profits tax taxable years. If the total capital at the end of the base period was as large as or larger than the total capital prior to the reduction of the borrowed capital, the average base period net income, to the extent that it was reduced by the interest deduction, would furnish an inadequate standard for determining excess profits. If, however, the total capital at the end of the base period was reduced by the amount by which the borrowed capital was reduced, the average base period net income would not necessarily furnish an inadequate standard for determining excess profits since the total amount of capital producing excess profits net income would also be reduced. For the purposes of section 722 (b) (4) a difference in the ratio of nonborrowed capital to total capital does not obtain merely because borrowed capital has been reduced or because equity invested capital has been increased. Such difference arises only when there is a decrease in borrowed capital offset by a corresponding increase in equity capital. In such event the amount of interest, on borrowed capital so retired during the base period, which has been deducted in computing average base period net income shall be disallowed as a deduction in computing constructive average base period net income. For the purposes of the preceding sentence, the amount of borrowed capital retired during the base period shall be limited to the increase in equity invested capital (whether by amounts paid in for stock, as paid-in surplus, or as contributions to capital, or by the amount of accumulated earnings and profits) for such period.

(5) The acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. The form in which such acquisition was accomplished and whether or not in a transaction in which taxable gain or loss was recognized is immaterial. For example, two competing newspapers were operating at a loss during all or part of the base period. Prior to January 1, 1940, the first newspaper purchased the franchises and other assets of the second newspaper and as a result of this transaction the condition of the surviving paper was much

more promising. A difference in the character of the business of the taxpayer has occurred.

Any change in the capacity for production or operation of the business consummated during an excess profits tax taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business.

If the taxpayer establishes that a change in the character of the business deemed to exist on December 31, 1939, actually entered into the operations of the business during the taxable year and that increased earnings would have been realized during the base period (or during some other period of normal earnings, if the base period is not a period of normal earnings) if the business so changed was in full operation during such period, the average base period net income shall be deemed to be an inadequate standard of normal earnings. The taxpayer must also establish by competent evidence that it was committed prior to January 1, 1940, to a course of action leading to such change. Such a commitment may be proved by a contract for the construction, purchase, or other acquisition of facilities resulting in such change, by the expenditure of money in the commencement of the desired change, by the institution of legal action looking toward such change, or by any other change in position unequivocally establishing the intent to make the change and commitment to a course of action leading to such change. The change in the capacity for production or operation referred to in the preceding paragraph means a change such as described in paragraph (d) (3) of this section.

A change in the character of the business deemed to be a change on December 31, 1939, pursuant to the last sentence of section 722 (b) (4), may not be reflected at all in the business of the taxpayer for an excess profits tax taxable year if such change had not yet been consummated by such year, may be partially reflected in such year to the extent that the new productive or operating capacity was utilized, or may be reflected in full for such year if the full normal capacity for production or operation so changed entered into the business of the taxpayer for such year. Consequently it is possible that the level of normal earnings based upon full normal operating capacity during the base period might exceed the level of earnings reached during an excess profits tax taxable year based upon but a portion of full operating capacity. No accurate computation of excess profits or of an unused excess profits credit for an excess profits tax taxable year can reasonably be made with respect to a taxpayer which has not reached full normal operating capacity in such year based upon a comparison of normal earnings representing full operating capacity of such change with excess profits net income from operations for such year based upon but a portion of normal operating capacity of such change. With respect to such an excess profits tax taxable year, the only fair and just standard of normal earnings to be included in the constructive average base period net income as attributable to such change must be based upon normal earnings attributable to the level of operations of the changed capacity for production or operation which normally would have been reached by the taxpayer during such year.

The extent to which the change in the capacity for production or operation entered into the business of the taxpayer for an excess profits tax taxable year shall be deemed to be the extent to which a change in capacity for production or operation existed on December 31, 1939. Therefore the fair and just amount to be included in the constructive average base period net income, as attributable to such change, in computing excess profits for any taxable year of a taxpayer which has consummated a change in capacity for production or operation after December 31, 1939, under section 722 (b) (4), and prior to the time that the full normal earning capacity of such change has been reached, shall be determined upon the basis of the extent to which the changed productive or operating capacity is reflected in the taxpayer's business for such year. The extent to which such changed capacity is reflected in the business for a taxable year shall be based upon the length of time during the taxable year in which the changed capacity for production or operation was utilized and the level of normal production or operation which was reached as the result of such changed capacity.

For an excess profits tax taxable year, prior to the attainment of full normal operating capacity, the fair and just amount of normal earnings attributable to a change in capacity for production or operation consummated after December 31, 1939, may be determined either by multiplying the full normal earnings attributable to normal operating capacity for the base period (or a comparable period) by a percentage representing the extent to which such change is reflected in the taxpayer's business for such year, or by determining normal earnings upon the basis of the operating level which normally would have been reached by such change during such year. To the extent necessary to determine the nature of the change in the capacity for production or operation, and the extent to which such change has been reflected in the taxpayer's business, regard may be had to facts existing after December 31, 1939. Although no regard should be had to actual earnings after December 31, 1939, as indicative of the amount of normal earnings attributable to the change, ratios existing between such earnings and earnings from other operations of the taxpayer or of similar taxpayers or an industry of which the taxpayer is a member may be taken into account. The principles applicable to the determination of the fair and just amount representing normal earnings to be included in constructive average base period net income as attributable to a changed capacity for production or operation shall also be applicable to the determination of such amount in the case of a taxpayer which has before May 31, 1941, acquired substantially all the assets of a competitor engaged in the dissemination of information through the public press, pursuant to the last sentence of section 722 (b) (4).

The determination of normal earnings both in the case of a taxpayer consummating a change in capacity for production or operation after December 31, 1939, and in the case of a taxpayer acquiring before May 31, 1941, assets of a competitor engaged in the dissemination of information through the public press, may be made in the same manner as the determination of normal earnings of a taxpayer which is deemed to have commenced business or to have changed the character of its business two years prior to the actual event.

In no event may any portion of a constructive average base period net income which is attributable to a change in the capacity for production or operation, or to the acquisition of assets of a competitor engaged in disseminating information through the public press with a concomitant elimination of competition be allowed in the computation of the excess profits tax for any taxable year in which such increased capacity or acquisition of assets and the effect of the elimination of competition do not enter into the business of the taxpayer, regardless of the fact that facilities giving rise to such increased capacity or representing assets acquired have been completely constructed or have been actually acquired in such year. For any excess profits tax taxable year subsequent to the year in which the changed capacity or the assets of the competitor and the elimination of competition have been reflected in the business of the taxpayer to the extent of full normal earning capacity, the constructive average base period net income shall include the entire amount of normal earnings attributable to such increased capacity or acquired assets and elimination of competition, regardless of the fact that in such later year the changed capacity or the acquisition of assets and the effect of the elimination of competition are not reflected to the extent of full normal earning capacity.

If a change in the capacity for production or operation, or the acquisition of assets of a competitor, occurs after December 31, 1939, amounts of money or property paid in to the taxpayer after the beginning of its first excess profits tax taxable year might be used in effectuating such change or acquisition. The amounts of money or property so paid in would constitute capital additions to be used in the determination of the net capital addition for an excess profits tax taxable year under section 713 (g) and section 743, and the excess

profits credit based on income is increased by 8 percent of the net capital addition under section 713 (a) (1) (B). In such case the amount otherwise determined as the fair and just amount representing normal earnings attributable to a changed capacity or an acquisition of assets and elimination of competition would duplicate that portion of the excess profits credit based on the net capital addition. Consequently, in computing the constructive average base period net income attributable to the change in the character of the business described in the last sentence of section 722 (b) (4), the fair and just amount representing normal earnings determined without regard to the provisions of this paragraph to be used in the computation of the excess profits tax for a taxable year shall be reduced by an amount equal to 8 percent of that portion of net capital addition for such year which has been utilized in constructing or acquiring the facilities giving rise to such change. Such portion of the net capital addition so utilized shall be deemed to be equal to that percentage of the net capital addition for such year as that portion of the aggregate of the daily capital additions considered to have been expended in the construction or acquisition of such facilities is of the aggregate of the daily capital additions. In no event, however, shall the amount of the constructive average base period net income attributable to the change be reduced to less than zero.

The effect of the last sentence of section 722 (b) (4) may be illustrated by the following examples:

In 1939, Corporation M, a mining company, began the development of a new mine and the construction of a new plant to be used in connection with such mine. The sum of $3,000,000 was expended upon this project in 1939 and 1940. Of this amount, $1,000,000 was paid in for stock of the corporation in 1939 and $2,000,000 was paid in for stock in 1940. Five hundred thousand dollars additional was paid in for stock in 1940 and used as working capital. Assume that for 1941 and 1942, the net capital addition is $2,250,000. The mine and plant were completed and entered production on October 1, 1941, thus being in operation for three-twelfths of the year 1941. During 1941, the level of production reached by the new facilities was 25 percent of normal operating capacity. The facilities were in operation during the entire year 1942 and reached a level of production of 75 percent of normal operating capacity. There will be considered to be a change in the character of the business on December 31, 1939, for purposes of the application of section 722 to the year 1941 and to subsequent years. No claim for relief based upon such facts may be made for the year 1940, since the new facilities were not a part of the taxpayer's business operations for such year. If it is assumed that full normal earnings attributable to full normal operating capacity is $400,000, the fair and just amount to be included in constructive average base period net income for 1941 attributable to the new facilities is $25,000 (three-twelfths multiplied by 25 percent of $400,000, i. e., three-twelfths multiplied by $100,000). This amount should be reduced by $144,000 representing an amount equal to 8 percent of that portion of the net capital addition which has been utilized in the construction of the new facilities (8 percent of $\frac{20}{25}$ of $2,250,000). Since the reduction of $144,000 exceeds the amount of $25,000, there is no constructive average base period net income attributable to the new facilities to be used in computing the excess profits tax for 1941. The fair and just amount to be included in constructive average base period net income for 1942 attributable to the new facilities is $300,000 ($400,000 multiplied by 75 percent). This amount should be reduced by $144,000 computed as provided above. The excess of $300,000 over $144,000, i. e., $156,000, is the amount of constructive average base period net income attributable to the new facilities to be used in computing the excess profits tax for 1942.

Radio broadcasting station R entered into a contract in July 1939, to change its basic network affiliation from a network with a low volume of business and local programs to one of the larger networks with a very large volume of business and Nation-wide programs. This change in the operation of the business enabled the station greatly to increase its revenue, and to serve a larger audience. Although the contract with the new network was signed in July 1939, actual broadcasting of the new network's programs did not start until March 1940. Corporation R, however, is considered to have been committed to a course of action prior to January 1, 1940, which led to a change in capacity for production and operation consummated after December 31, 1939, and thus to have established a change in the character of its business on December 31, 1939.

In April 1941, an evening newspaper acquired substantially all of the assets employed in publishing a competitive morning newspaper, with the result that competition between the taxpayer and the competitor existing prior to January 1, 1940, was eliminated. A change in the character of the business is deemed to have occurred on December 31, 1939, and the taxpayer is eligible for relief under section 722 for the year 1941 and subsequent years.

(e) *Other factors affecting business and resulting in inadequate standard of normal earnings.* If the taxpayer establishes the presence during or immediately prior to the base period of one or more factors which may reasonably be considered to have influenced adversely operations during the base period and to have resulted in unusually low earnings during the base period, and the application of section 722 to the taxpayer would not be inconsistent with the principles underlying the provisions of section 722 (b) and with the conditions and limitations enumerated in such section, the average base period net income shall be deemed to be an inadequate standard of normal earnings.

The purpose of section 722 (b) is to make eligible for relief under section 722 a corporation which would normally use the excess profits credit based on income in ascertaining income subject to excess profits tax but which has experienced conditions affecting it or an industry of which it was a member resulting in an average base period net income which is not an adequate reflection of average normal earnings and which consequently is not an adequate measurement for the determination of excess profits. The excess profits tax is specifically designed to recapture a portion of profits due to the expansion and creation of activities by the war effort. Profits earned during the current excess profits tax return period can therefore furnish no competent guide to what constitutes normal average earnings. The mere fact that the average base period net income of a taxpayer is somewhat, or even considerably, smaller than its anticipated or actual excess profits net income does not necessarily mean that the average base period net income is an inadequate standard of normal earnings. Such average base period net income may reflect the result of normal operations; a larger current income may reflect the effects of the war economy and truly constitute excess profits to be taxed. Since current excess profits net income cannot be taken into account in determining constructive average base period net income, the mere disparity between average base period net income and current income is no basis for a claim for relief under section 722 (b) (5).

Eligibility for relief under section 722 (b) (5) and the determination of a constructive average base period net income must not be inconsistent with the principles, conditions, and limitations contained in section 722 (b) (1), (2), (3), and (4) and § 35.722–3 (a), (b), (c) and (d).

§ 35.722–4 *Determination of excessive and discriminatory tax; taxpayer not entitled to excess profits credit based on income.* Section 722 (c) defines an excessive and discriminatory excess profits tax, computed without regard to the provisions of section 722, for an excess profits tax taxable year, in the case of a taxpayer which is not entitled to use the excess profits credit based on income pursuant to section 713 (or pursuant to section 742, if the taxpayer has acquired the assets of another corporation). This section applies to taxpayers coming into existence after December 31, 1939, which are not entitled to use the excess profits credit based on average base period net income, and to foreign corporations compelled to use the excess profits credit based on invested capital (see section 712 (b)). The excess profits tax of such corporations, computed without regard to section 722, shall be considered to be excessive and discriminatory if the excess profits credit based on invested capital is an inadequate standard for determining excess profits because of one or more of the following reasons:

(a) The business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income. Corporation M commenced business in 1940. Its business was of a class which required little invested capital but necessitated the establishment of contacts with the trade in which it would obtain its customers. It lost money during its first two years of operation, but by 1942 had built up patronage and showed a considerable profit. If its invested capital was very small, its excess profits credit based on invested capital would be an inadequate standard for determining excess profits, and the corporation would be entitled to file a claim for relief under section 722 for the year 1942 and subsequent years.

(b) The business of the taxpayer is of a class in which capital is not an important income-producing factor. An illustration might be a corporation commencing business in June, 1940, doing

business as fashion consultants. Although the corporation operates with very little invested capital, it cannot qualify as a personal service corporation under section 725 because it employs a large technical and professional staff. The excess profits credit based upon low invested capital would be an inadequate standard for determining excess profits.

(c) The invested capital of the taxpayer is abnormally low. If the type of business done by the taxpayer is not one in which invested capital is small but the invested capital of the taxpayer is unusually low because of peculiar conditions existing in its case, the excess profits credit based on invested capital will be considered an inadequate standard for determining excess profits. Thus, suppose that a corporation commenced business in 1941 with a leased plant valued at $1,000,000, but with equity invested capital and borrowed capital of only $40,000. If the invested capital of such company is unusually low relative to the size of its operations, its excess profits credit based on invested capital might be an inadequate standard for determining excess profits, and the taxpayer would be subject to an unreasonable tax burden if required to compute its excess profits tax under the invested capital method.

The last sentence of section 722 (a) permits consideration to be given to the nature of the taxpayer and the character of its business under section 722 (c) existing after December 31, 1939, to the extent necessary to establish the normal earnings to be used as constructive average base period net income. In the case of a taxpayer commencing business after December 31, 1939, it is necessary to examine the type of business engaged in, the relationship between its profits and invested capital, its profits and sales, and the profits and invested capital and profits and sales of comparable concerns, the earning capacity of the taxpayer, the character and experience of the management, the nature of the competition encountered, and all other factors pertinent in constructing normal earnings. The mere fact that earnings after December 31, 1939, exceed the amount of the excess profits credit based on invested capital is not of itself an indication that the taxpayer is of a class which shows a higher than average return upon capital or that its invested capital is abnormally low. Therefore any facts or conclusions derived with respect to the period after December 31, 1939, shall be related to the base period; or, if the base period does not represent a period of normal earnings for the type of business exemplified by the taxpayer, to another period of average normal earnings; and in either case the taxpayer must establish that it would satisfy the provisions and conditions of section 722 (c) and of this section for such period.

No exact criteria can be prescribed for the computation of the constructive average base period net income of a taxpayer described in this section. In some cases it may be the average of normal earnings reconstructed for the 48 months preceding the beginning of its first excess profits tax taxable year which would have begun in 1940 (but not after May 31, 1940); in others it might be determined without reconstructing the income for each year in a fictitious base period. In still other cases, if the taxpayer is a member of an industry which was depressed during the base period or which has a variant business cycle or sporadic and intermittent periods of prosperity, the constructive average base period net income might be determined by reference to the average earnings of comparable businesses in the same industry computed for a period of normal average earnings or computed as the average earnings over the period of existence of the industry. If the taxpayer's business is a continuation of a preexisting business enterprise, regard might be had to the experience and earning capacity of such enterprise in order to ascertain normal earnings to be attributed to the taxpayer.

As in the case of taxpayers which are deemed to have commenced business or changed the character of the business two years prior to the actual event, and of taxpayers which after December 31, 1939, have consummated a change in the capacity for production or operation as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, it may not be possible to reconstruct demand, sales, and selling prices based upon such demand and sales upon the basis of actual economic conditions existing within the framework of the base period or other period established to be a period of normal earnings. In certain cases actual demand, sales, and selling prices might not represent reasonable limitations upon the earning level which the taxpayer would have attained had it been in existence during such period. Moreover, the fact that normal earnings are being reconstructed for such period for a business which was not then in existence implies the existence of conditions not necessarily present in the period for which reconstruction is being made. Consequently in proper cases, demand, sales, and selling prices may be established upon the basis of certain assumptions not inconsistent with the hypothesis that the taxpayer was in existence and attained its normal earning level during such period, and not inconsistent with the experience of similar taxpayers which have reached a level of normal earnings, or of an industry of which the taxpayer is a member, which might furnish an indication of economic factors which would have been encountered by the taxpayer in such period.

Since business normally requires a period of development after commencement before attainment of normal earning capacity, the full amount of normal earnings upon which would be based the constructive average base period net income may exceed the excess profits net income for an excess profits tax taxable year. No accurate computation of excess profits or of an unused excess profits credit for an excess profits tax taxable year can reasonably be made with respect to a taxpayer which has not reached full normal earning capacity in such year based upon comparison of normal earnings representing full operating capacity with excess profits net income from operations for such year based upon but a portion of normal operating capacity. With respect to such an excess profits tax taxable year, prior to the year in which the taxpayer has reached its full earning capacity, the only fair and just standard of normal earnings to be used as the constructive average base period net income for such year shall be based upon normal earnings attributable to the level of operations which normally would have been reached by the taxpayer during such year. Such normal earnings may be determined in the same manner as in the case of a change in the capacity for production or operation consummated during a taxable year beginning after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940. See § 35.722–3 (d).

Amounts paid into a corporation which is organized and commences business after December 31, 1939, after the beginning of its first excess profits tax taxable year constitute capital additions under section 713 (g) or section 743. An amount equal to 8 percent of the net capital addition is included in computing the excess profits credit based on income under section 713 (a). Since the amount of normal earnings to be used as the constructive average base period net income must be based upon the nature and character of a taxpayer as it exists on a certain date, a portion of such normal earnings may duplicate a portion of the excess profits credit based upon the net capital addition. In order to obviate such duplication, no amount shall be included in the net capital addition which is included in determining the nature of the taxpayer and the character, kind, and size of its business upon the basis of which is determined the constructive average base period net income. Consequently, in any case in which the taxpayer has claimed relief under the provisions of section 722 (c), the beginning of the taxpayers' first excess profits tax taxable year for the purposes of computing that portion of the excess profits credit reflecting net capital additions or reductions under sections 713 (g) and 743, shall be considered to be that date after which capital additions and capital reductions are not taken into account in computing constructive average base period net income. For example, assume that a corporation reporting income on the basis of a calendar year commenced business on April 1, 1940, with $100,000 of property paid in for stock. By November 1, 1940, $200,000 additional had been paid in, and by the end of its taxable year, December 31, 1940, $10,000 additional had been paid in. It is assumed that the corporation is entitled to relief under section 722, and it is determined that a constructive average base period net income should be established with respect to the nature and character of the business of the taxpayer which existed on November 1, 1940. For the purposes of an adjustment to the excess profits credit on account of net capital

additions or reductions based upon section 713 (g), November 1, 1940, rather than April 1, 1940, will be deemed to be the beginning of the taxpayer's first excess profits tax taxable year.

§ 35.722–5 *Application for relief under section 722*—(a) *Requirements for filing.* Except as provided in section 710 (a) (5) and § 35.710–5 (relating to deferment of payment of excess profits tax in certain cases under section 722) and except as provided in (e) of this section, the taxpayer is not permitted to claim the benefits of section 722 in computing its excess profits tax on its return, but must compute its tax, file its return, and pay its excess profits tax without the application of section 722. To obtain the benefits of section 722 for any taxable year beginning after December 31, 1941, a taxpayer not later than six months after the date prescribed by law for the filing of its excess profits tax return for such year must file under oath an application on Form 991 (revised January, 1943) for the benefits of section 722, unless the taxpayer has deferred on its return a portion of its excess profits tax under section 710 (a) (5), or unless the provisions of (d) and (e) of this section are applicable to the taxpayer. For the purposes of this section, the time prescribed by law for filing the return includes the period of any extension of time granted for such filing.

In order to obtain the benefits of an unused excess profits credit computed by using the excess profits credit based on constructive average base period net income for an excess profits tax taxable year beginning after December 31, 1941, as an unused excess profits credit carryover, the taxpayer must file an application on Form 991 (revised January, 1943) not later than six months after the date prescribed by law for the filing of the excess profits tax return for the year to which such unused excess profits credit carry-over is desired to be applied, except as otherwise provided in (e) of this section. In order to obtain the benefits of an unused excess profits credit computed by using the excess profits credits based on constructive average base period net income for any taxable year as an unused excess profits credit carry-back, a timely application for relief must be filed with respect to the taxable year in which such unused excess profits credit arose except as otherwise provided in (e) of this section. In addition a claim for refund or credit on Form 843 claiming the benefit of the carry-back shall be filed within the period of limitation provided in section 322 applicable to the year to which such carry-back is to be applied.

Except as otherwise provided in this section, the application on Form 991 (revised January, 1943) must set forth in detail and under oath each ground under section 722 upon which the claim for relief is based, and facts sufficient to apprise the Commissioner of the exact basis thereof. The mere statement of the provision or provisions of law under section 722 upon which the claim for relief is based shall not constitute an application for relief within the meaning of section 722. If a claim for relief is based upon section 722 (b) (5) and § 35.722–3 (e) (relating to factors other than those expressly provided by section 722 (b) (1), (2), (3), and (4) and § 35.722–3 (a), (b), (c), and (d)), the application must state the factors which affect the business of the taxpayer, which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period, and the reasons why the extension of relief under section 722 to the taxpayer would not be inconsistent with the principles underlying the provisions of sections 722 (b) (1), (2), (3), and (4), and § 35.722–3 (a), (b), (c), and (d), and with the conditions and limitations enumerated therein. If it is not possible for the taxpayer within six months from the date prescribed by law for filing its excess profits tax return to obtain, prepare, and present all the detailed information required to establish its eligibility for relief and the amount of its constructive average base period net income, such information may be submitted within a reasonable time after filing the application as a supplement to the application. No new grounds presented by the taxpayer after the date prescribed by law for filing its application will be considered in determining eligibilty for relief or the amount of the constructive average base period net income to be used in computing such relief for a taxable year.

If an application for relief has been filed for any prior excess profits tax taxable year, whether under section 722 prior to its amendment by the Revenue Act of 1942 or after such amendment, and if a constructive average base period net income has not been finally determined which may be used by the taxpayer in computing its excess profits tax for the current year, the supporting data and information submitted with such earlier application need not be repeated in Form 991 (revised January, 1943) filed for the current year provided reference is made to such earlier application as constituting part of Form 991 (revised January, 1943) filed for the current year.

In any case in which the taxpayer claims on its excess profits tax return, in accordance with section 710 (a) (5) and § 35.710–5, the benefit of a tax deferment under section 710 (a) (5), it must attach duplicate copies of its completed application for relief under section 722 on Form 991 (revised January, 1943) to its excess profits tax return on Form 1121. If a taxpayer files an excess profits tax return on which is deducted a tax deferment claimed under section 710 (a) (5) without attaching a completed Form 991 (revised January, 1943) thereto, the taxpayer will not be deemed to have claimed on its return in accordance with section 710 (a) (5) and § 35.710–5 the benefits of section 722 (See § 35.710–5.) In such case, the amount of tax shown on the return shall be the amount shown by the taxpayer, increased by the amount of tax deferment improperly claimed. In order to obtain the benefits of section 722 with respect to the tax shown on the return, the taxpayer must file an application for relief under section 722 on Form 991 (revised January, 1943) not later than six months after the date prescribed by law for the filing of the return.

(b) *Method of filing and information required.* The application on Form 991 (revised January, 1943) shall be filed in duplicate with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Clearing Division, Claims Control Section, except in those cases in which the taxpayer claims on its excess profits tax return the benefit of a tax deferment pursuant to section 710 (a) (5). In such latter event, the application shall be executed in duplicate and attached to the taxpayer's excess profits tax return on Form 1121 for the taxable year for which such deferment is claimed. Such application shall, in accordance with the provisions of this section, and the instructions on Form 991 (revised January, 1943) set forth the following information:

(1) The name and address of the corporation;

(2) The date and place of incorporation;

(3) The excess profits tax taxable year for which the benefits of section 722 are claimed;

(4) The collection district in which the excess profits tax return for such year was filed;

(5) The date on which the excess profits tax return for the year was filed and the period of extension, if any, granted for the filing of such return;

(6) The excess profits tax shown upon the excess profits tax return for the year (computed prior to the deferment under section 710 (a) (5), to the foreign tax credit under section 729, to the credit for debt retirement under section 733, and to the adjustment under section 734);

(7) The excess profits tax computed after the application of section 722 (computed as prescribed in line 6);

(8) The reduction in tax resulting from the application of section 722;

(9) The adjusted excess profits net income computed without regard to section 722;

(10) The normal tax net income computed without regard to the credit provided in section 26 (e) relating to income subject to excess profits tax;

(11) The percentage of which line 9 is of line 10;

(12) The amount of tax deferred under section 710 (a) (5);

(13) The total net relief claimed with respect to the excess profits tax shown on the return;

(14) The total excess profits tax for the taxable year paid at or prior to the time the application is filed;

(15) The amount of refund or credit for which the application is a claim;

(16) If the application is filed as a result of a deficiency:

(i) The excess profits tax shown in the preliminary notice or notice of deficiency,

(ii) The excess profits tax after application of section 722, and

(iii) The reduction in tax under section 722;

(17) The prior taxable year or years for which an application for a constructive average base period net income has been made;

(18) Whether a constructive average base period net income has been finally determined and used in connection with a prior taxable year, and if so:

(i) The amount determined for use in computing excess pofits tax for a prior year,

(ii) The year for which such amount was used,

(iii) The date of determination,

(iv) By whom the determination was made,

(v) The reason for a claim for a constructive average base period net income for use in the taxable year if different from the amount used in a prior year,

(vi) Whether the membership of an affiliated group filing consolidated excess profits tax returns has changed from the year in which a constructive average base period net income was finally determined for such group;

(19) The excess profits net income or deficit in excess profits net income for each taxable year in the base period computed without regard to section 722;

(20) The average base period net income determined without regard to section 722, together with information and computations showing whether there is claimed:

(i) The benefit of section 713(e) (relating to exclusion of deficit or to increase in lowest year in base period), or

(ii) The benefit of section 713(f) (relating to increased earnings in last half of base period);

(21) The amount and the computation of the constructive average base period net income claimed for use in computing excess profits tax for the taxable year;

(22) Whether Supplement A has been availed of in determining average base period net income, and whether a separate constructive average base period net income has been finally determined for any component prior to the time the application is made;

(23) If the business was commenced during the base period or after December 31, 1939, whether such business is a continuation in whole or in part of a previously existing business, and if so, a statement of particulars;

(24) If the taxpayer is a member of an affiliated group making a consolidated excess profits tax return, and if such group is making application for relief under section 722:

(i) The first taxable year for which a consolidated excess profits tax return was made,

(ii) Whether a constructive average base period net income has been finally determined for any member of the group, and

(iii) Names and addresses of each member of the group, and all pertinent information necessary to determine constructive average base period net income of such group;

(25) If the taxpayer came into existence after December 31, 1939, the date after which capital additions and capital deductions were not taken into account in computing constructive average base period net income;

(26) If the benefits of section 711 (a) (1) (I) or 711 (a) (2) (K) (relating to nontaxable income of certain industries with depletable resources) are claimed, a schedule showing the computation of, and the fair and just amount of:

(i) Normal output during the base period, as defined in section 735 (a) (5),

(ii) Normal unit profit as defined in section 735 (a) (9);

(27) If normal production, output, or operation was interrupted during the base period because of unusual and peculiar events (section 722 (b) (1)):

(i) A description of the events and time of occurrence, and

(ii) The taxable years in the base period during which production output or operations were affected;

(28) If the business of the taxpayer was depressed during the base period, or the taxpayer was a member of an industry which was depressed during the base period because of temporary and unusual economic events (section 722 (b) (2)):

(i) A description of the temporary economic events unusual in the case of the taxpayer or an industry of which it was a member, and

(ii) If claim of depression is based on membership in a depressed industry, description of industry, and names and addresses of other members of such industry;

(29) If the business of the taxpayer was depressed in the base period because of membership in an industry affected by conditions subjecting the taxpayer to either a profits cycle differing materially from the general business cycle (section 722 (b) (3) (A)), or sporadic and intermittent periods of profits inadequately represented in the base period (section 722 (b) (3) (B)):

(i) A description of the character of the industry, and names and addresses of other members of the industry,

(ii) Data establishing that the taxpayer was depressed by reason of an unusual profits cycle, or

(iii) Data establishing that the taxpayer was depressed by reason of realization of sporadic profits inadequately represented in the base period;

(30) If the business of the taxpayer was commenced, or if there was a change in the character of the business, immediately prior to or during the base period (section 722 (b) (4)):

(i) The date upon which the commencement of business or the change in the character of the business occurred,

(ii) If a change in the character of the business has occurred:

(*a*) The nature of the change,

(*b*) The portion of the definition in section 722 (b) (4) within which such change is claimed to fall, and

(*c*) Evidence supporting the contention that the average base period net income does not reflect normal operations for the entire base period,

(iii) If the business did not reach by the end of the base period the earning level it would have reached if the business has been commenced, or if the change in character of the business had occurred two years prior to the time the commencement or change occurred, a statement of particulars,

(iv) If a change in capacity for production or operation of the business was consummated during the taxable year beginning after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940:

(*a*) The date upon which such change was consummated, and the extent to which income for such year reflects such change,

(*b*) Evidence of commitment to a course of action prior to January 1, 1940,

(*c*) A schedule showing net capital addition or net capital reduction (section 713 (g) (1) or (2)), and the amount of money or property expended after beginning of the first excess profits tax taxable year under the Internal Revenue Code in changing the capacity for production or operation of the business;

(31) If other factors produce an average base period net income which is an inadequate standard of normal earnings, and if the application of section 722 is not inconsistent with the principles and limitations of section 722 (b) (section 722 (b) (5)):

(i) A description of other factors claimed to affect business during the base period and to result in an average base period net income which is an inadequate standard of normal earnings;

(32) If the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income (section 722 (c) (1)):

(i) Description of character of intangible assets, and

(ii) Names and addresses of other corporations believed to be in the same class of business where intangible assets of a similar character make important contributions to income;

(33) If the business of the taxpayer is of a class in which capital is not an important income-producing factor (section 722 (c) (2)):

(i) A description of the nature of the business and an explanation of why capital is not an important income-producing factor, and

(ii) Names and addresses of other corporations believed to be in the same class of business in which capital is not an important income-producing factor;

(34) If the invested capital of the taxpayer is abnormally low (section 722 (c) (3)):

(i) A description of the circumstances causing invested capital to be abnormally low;

(35) Such other information as may be required by the instructions appearing on Form 991 (revised January 1943) or issued therewith.

(c) *Claim for refund.* The application on Form 991 or Form 991 (revised January 1943) shall be considered a claim for refund or credit with respect to the excess profits tax for the taxable year for which the application is filed which has been paid at or prior to the time such application is filed. The amount

of credit or refund claimed shall be the excess of the amount of excess profits tax for the taxable year paid over the amount of excess profits tax claimed to be payable computed pursuant to the provisions of section 722. In case the taxpayer elects to pay in installments the tax shown upon its return and at the time the application is filed such tax has not been paid in full, the taxpayer should file a claim for refund on Form 843 as promptly as possible after such tax has been paid in full. The information already submitted in the application need not again be submitted on Form 843 if reference is made therein to such application. For limitations upon refunds and credits generally, see section 322. As to procedure upon disallowance of a claim for refund of an excess profits tax which is claimed to be excessive and discriminatory under section 722, see section 732.

(d) *After assertion of deficiency.* If a taxpayer does not file prior to September 16, 1943, with respect to an excess profits tax taxable year beginning in 1940 or 1941 or within the 6-month period provided in section 722 (d) with respect to an excess profits tax taxable year beginning after December 31, 1941, an application under (a) and (b) of this section, it may nevertheless obtain relief under section 722 for such year if there is a deficiency in excess profits tax asserted against it for such year. In such case, the operation of section 722 shall not reduce the excess profits tax for such year determined without reference to such section by an amount in excess of the amount of the deficiency finally determined without reference to such section.

If a preliminary notice of deficiency is issued, the taxpayer may obtain the limited benefits of section 722 described in the preceding paragraph by filing an application on Form 991 (revised January, 1943) within 90 days after the date of such notice, regardless of when or whether a formal notice of deficiency is issued. (See section 272 (a).) If a formal notice of deficiency is issued without the issuance of a preliminary notice or within 90 days after the issuance of a preliminary notice, the taxpayer may claim such benefits in its petition, or amended petition, to The Tax Court of the United States filed in accordance with the rules of The Tax Court and with respect to the deficiency asserted in such formal notice. If, however, a preliminary notice is issued and the taxpayer does not file a timely application on Form 991 (revised January, 1943), and a formal notice of deficiency is issued after the expiration of 90 days from the date of the preliminary notice, the taxpayer cannot claim the benefits of section 722 in a petition, or amended petition filed with The Tax Court of the United States.

A taxpayer filing an application on Form 991 (revised January, 1943) after a preliminary notice of deficiency shall attach to such application a copy of such notice.

(e) *Waiver of limitations for subsequent taxable years.* If constructive average base period net income is finally determined under section 722 (a) with respect to a taxpayer, or if permission is granted by the Commissioner after a determination which has not become final, and if, in the opinion of the Commissioner, no substantial evidence exists which requires a redetermination of such constructive average base period net income for use in any subsequent taxable year, such taxpayer may without the filing of any application on Form 991 (revised January, 1943) use the constructive average base period net income so determined, except as further adjustments may be required by section 711 (b), in computing its excess profits credit based on income and its excess profits tax in any return required to be filed thereafter. If a taxpayer, which pursuant to the preceding sentence would otherwise be entitled to use a constructive average base period net income previously determined, is acquired by another corporation in a transaction which under Supplement A constitutes it a component corporation and the transferee an acquiring corporation, or if such taxpayer becomes a member of an affiliated group which makes a consolidated excess profits tax return, the average base period net income of the acquiring corporation, or the consolidated average base period net income of the affiliated group, as the case may be, may not as of right include such constructive average base period net income. To obtain the benefits of section 722, such acquiring corporation or affiliated group of corporations must file an application on Form 991 (revised January, 1943) and establish eligibility for relief and the fair and just amount representing normal earnings to be used as the constructive average base period net income.

Eligibility for relief and a constructive average base period net income finally determined on behalf of a taxpayer with respect to an excess profits tax taxable year may have to be reestablished with respect to a subsequent taxable year if:

(1) The taxpayer, after the year with respect to which such determination was made, acquires a component corporation in a transaction constituting it an acquiring corporation under Supplement A,

(2) The membership of the taxpayer which is an affiliated group of corporations making consolidated excess profits tax returns has changed subsequent to the year with respect to which the determination was made,

(3) The taxpayer which is an affiliated group of corporation makes its first consolidated excess profits tax return subsequent to the year with respect to which such determination was made on behalf of one or more members of the group,

(4) The taxpayer is deemed to have commenced business or changed the character of its business two years prior to the actual event, and as of the close of its base period could not reasonably except to realize its full earning capacity in the year with respect to which the determination was made,

(5) The taxpayer has effected a change in capacity for production or operation after December 31, 1939, as a result of a course of action to which it was committed prior to January 1, 1940, and the full effect of such change was not reflected in the operations of the business in the year with respect to which the determination was made,

(6) The taxpayer commenced business after December 31, 1939, and the business had not reached its full earning capacity in the year with respect to which the determination was made.

SEC. 723. EQUITY INVESTED CAPITAL IN SPECIAL CASES. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 205 (f), Rev. Act 1942.]

(a) Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this subchapter cannot be determined in accordance with section 718, the equity invested capital as of the beginning of such year shall be an amount equal to the sum of (a) the money plus (b) the aggregate of the adjusted basis of the assets of the taxpayer held by the taxpayer at such time, such sum being reduced by the indebtedness outstanding at such time. The amount of the money, assets, and indebtedness at such time shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary. In such case, the equity invested capital for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as so determined.

(b) The equity invested capital of mutual insurance companies other than life, or marine, shall be the mean of the surplus, plus 50 per centum of the mean of all reserves required by law, both surplus and reserves being determined at the beginning and end of the taxable year. The surplus shall include all of the assets of the company other than reserves required by law.

§ 35.723–1 *Rules where equity invested capital cannot be determined under section 718.* In cases in which the Commissioner determines that the equity invested capital of a corporation as of the beginning of its first excess profits tax taxable year can not be determined in accordance with section 718, such equity invested capital shall be an amount equal to the sum of (a) the money, plus (b) the aggregate of the adjusted basis of the assets other than money, held by the corporation as of the beginning of such taxable year, such sum being reduced by the indebtedness of the corporation outstanding at such time. The adjusted basis of the assets shall be the adjusted basis for determining loss upon a sale or exchange for Federal income tax purposes. See, in general, section 113 and the regulations prescribed thereunder. For the purposes of section 723 the term "indebtedness" means any liability of the corporation, absolute and not contingent, and includes liabilities assumed by the corporation, whether or not in connection with property held by the taxpayer, and any liabilities to which property held by the corporation is subject, but does not include the obligation of the corporation on its capital stock.

The equity invested capital under section 723 for each day after the first day of the first excess profits tax taxable year of the corporation shall be the

basic figure determined under the first paragraph of this section increased or decreased as provided in section 718 and the regulations prescribed thereunder with respect to changes in the equity invested capital occurring after the beginning of such first taxable year. For such purpose the term "accumulated earnings and profits" means the earnings and profits accumulated since the beginning of the first excess profits tax taxable year of the corporation, computed without regard to any deficit in accumulated earnings and profits existing at the beginning of such year. Similarly, the term "earnings and profits" refers only to such accumulated earnings and profits and earnings and profits of an excess profits tax taxable year. In all cases coming under section 723 the taxpayer shall be treated as a corporation newly organized immediately prior to the beginning of its first excess profits tax taxable year with an equity invested capital, consisting of money paid in for stock, equal to the basic figure determined under section 723.

In any case in which a taxpayer finds it impossible to determine its equity invested capital as of the beginning of its first excess profits tax taxable year in accordance with section 718, it may compute its equity invested capital in accordance with section 723, provided it submits with its return a schedule showing such computation, and a statement of the facts upon which it bases its conclusion that it can not compute its equity invested capital under section 718, so that the Commissioner may determine whether its equity invested capital can be computed in accordance with that section.

§ 35.723–2 *Equity invested capital of mutual insurance companies other than life or marine.* The equity invested capital of mutual insurance companies other than life or marine shall be determined as provided in section 723 (b) rather than section 718. The equity invested capital of such insurance companies for any such year shall be the mean of the surplus, plus 50 percent of the mean of all reserve required by law, both surplus and reserve being determined at the beginning and end of the taxable year. For this purpose surplus means the excess of all the assets of the company over the sum of the liabilities of the company, including in such liabilities the reserves required by law. In determining such excess, all the assets of the company, whether admitted or not admitted, shall be included. "Reserves required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, and unpaid brokerage. Only reserve commonly recognized as such in insurance accounting are to be taken into consideration in computing the "reserves required by law." In the case of a fire insurance company the only reserves commonly recognized are the "unearned-premiums."

SEC. 724. FOREIGN CORPORATIONS AND CORPORATIONS ENTITLED TO BENEFITS OF SECTION 251—INVESTED CAPITAL. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 212 (a), Rev. Act 1942.]

Notwithstanding section 715, in the case of a foreign corporation engaged in trade or business within the United States, and in the case of a corporation entitled to the benefits of section 251, the invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, under which—

(a) *General rule.* The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 720 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms "admissible assets" and "inadmissible assets" shall include only United States assets; or

(b) *Exception.* If the Commissioner determines that the United States assets of the taxpayer cannot satisfactorily be segregated from its other assets, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

(c) *Definition of United States asset.* As used in this subsection, the term "United States asset" means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

§ 35.724–1 *Invested capital of certain foreign corporations and corporations entitled to benefits of section 251.* In the case of a foreign corporation engaged in trade or business within the United States, and in the case of a corporation entitled to the benefits of section 251 (on account of deriving a large portion of its gross income from possessions of the United States), the invested capital for any taxable year shall be invested capital as provided in section 715, 716, 717, and 720, with the following exceptions:

(a) The daily invested capital for each day in the taxable year shall be the aggregate of the adjusted basis of each United States asset as defined in (d) below held by the taxpayer on the beginning of such day. The adjusted basis of each such asset shall be the adjusted basis for determining loss upon a sale or exchange for Federal income tax purposes. The amount of United States assets held at the beginning of each day of the taxable year shall be determined in the same manner as the amount of admissible and inadmissible assets is determined under § 35.720–1. The daily invested capital computed under this section is not affected by the indebtedness of the corporation, and does not include borrowed capital as defined in section 719.

(b) In the application of section 720 in reduction of the average invested capital (determined on the basis of the daily invested capital as provided in (a) above), the terms "admissible assets" and "inadmissible assets" shall include only United States assets. The amount of such admissible assets and inadmissible assets shall be determined in the same manner as provided in § 35.720–1.

(c) In cases in which the Commissioner determines that the United States assets of a corporation can not satisfactorily be segregated from its other assets, the invested capital of the corporation for the taxable year shall be an amount which is the same percentage of the aggregate adjusted basis (for determining loss) of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year. For the purposes of this paragraph the net income of the corporation from sources within the United States shall be determined as provided in section 119 and the regulations prescribed thereunder. The provisions of sections 715 and 720 relating to adjustment for inadmissible assets have no application in determining invested capital under section 724 (b).

(d) For the purposes of section 724 the term "United States asset" means an asset either (1) employed by the taxpayer in the United States in carrying on its trade or business therein, or (2) of a kind the income from which is income from sources within the United States under section 119 and the regulations prescribed thereunder irrespective of where the evidence of the property right in such asset is held.

SEC. 725. PERSONAL SERVICE CORPORATIONS. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 223 (b), Rev. Act 1942.]

(a) *Definition.* As used in this subchapter, the term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 70 per centum in value of each class of stock of the corporation, and in which capital is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal. For the purposes of this subsection, an individual shall be considered as owning, at any time, the stock owned at such time by his spouse or minor child or by any guardian or trustee representing them.

(b) *Election as to taxability.* If a personal service corporation signifies, in its return under Chapter 1 for any taxable year, its desire not to be subject to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation. Such corporation shall not be exempt for such year if it is a member of an affiliated group of corporations filing consolidated returns under section 141.

§ 35.725–1 *Taxation of personal service corporations.* A personal service corporation is subject to the excess profits tax imposed under Subchapter E of Chapter 2 the same as any other domestic corporation unless it elects as to any

taxable year not to be subject to such tax. Such an election may not be exercised by a corporation filing a consolidated return under section 141. If a corporation is exempt by reason of the exercise of such an election, the provisions of Supplement S of Chapter 1 (sections 391 to 396, inclusive) shall apply to the shareholders in such corporation who were such shareholders on the last day of the taxable year of the corporation. See § 29.394–1 of this chapter. In such case, the amount of the undistributed Supplement S net income shall be considered as paid in to the corporation as of the close of the taxable year as paid-in surplus or as a contribution to capital, and the amount of accumulated earnings and profits as of the close of such year shall be correspondingly reduced. See section 394 (d).

§ 35.725–2 *Definition of personal service corporation*—(a) *In general.* The term "personal service corporation" means a domestic corporation in which capital is not a material income-producing factor and the income of which is to be ascribed primarily to the activities of shareholders who (1) are regularly engaged in the active conduct of the affairs of the corporation, and (2) are the owners, throughout the entire taxable year of at least 70 percent in value of each class of stock of the corporation.

If 50 percent or more of the gross income of a corporation consists of gains, profits, or income derived from trading as a principal, such corporation can not be considered to be a personal service corporation. As to corporations in which less than 50 percent of the gross income is derived from trading as a principal, see (c) below.

(b) *Stock interest of shareholders.* Shareholders regularly engaged in the active conduct of the affairs of the corporation and to whom the income of the corporation is primarily to be ascribed must own at all times during the taxable year at least 70 percent in value of each class of stock of the corporation. If stock is owned by the spouse or minor child of an individual, or owned by the guardian or trustee of such spouse or child, such stock is treated as being owned by such individual.

A corporation can not be considered to be a personal service corporation for any taxable year if another corporation owns more than 30 percent in value of any class of its stock at any time during such year. A corporation is an artificial entity and can not itself be regularly engaged in the active conduct of the affairs of another corporation within the meaning of section 725.

The fact that the ownership of shares in the corporation may change during the course of the taxable year does not take the corporation which is otherwise a personal service corporation out of that class unless at some time during the taxable year the ownership of more than 30 percent in value of the shares of any class of stock passes into the hands of persons not regularly engaged in the active conduct of the affairs of the corporation.

(c) *Income to be ascribed primarily to the activities of shareholders.* If employees other than shareholders contribute substantially to the services rendered by a corporation, such corporation is not a personal service corporation unless, in every case in which services are so rendered, the value of and the compensation charged for such services are to be attributed primarily to the experience or skill of the shareholders and such fact is evidenced in some definite manner in the normal course of the business or profession. The fact that the shareholders give personal attention or render valuable services to the corporation as a result of which its earnings are greater thon those of a corporation engaged in a like or similar business or profession, the shareholders of which are not regularly engaged in the activities of the corporation, does not of itself constitute the corporation a personal service corporation.

Income of a corporation from merchandising or trading as a principal, directly or indirectly, in commodities or in the services of others is not to be ascribed primarily to the activities of its shareholders. Income of a corporation from the conduct of an auction, agency, brokerage, or commission business strictly on the basis of a fee or commission may be so ascribed. If, however, either as a matter of business policy or by contract, the corporation assumes any such risks as those of market fluctuations, bad debts, or failure to accept shipments, or if it guarantees the accounts of the purchaser or is in any way accountable to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commission or fee in a transaction is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary.

It may happen that a corporation is engaged in two or more businesses or professions which are more or less related. Thus, an engineering concern may also engage in contracting, which amounts to trading in materials and labor, or a brokerage concern may guarantee some of its accounts, or a photographic concern may sell pictures, frames, art goods, and supplies. In such cases, the corporation is not a personal service corporation unless the activities of the corporation consisting of trading or guaranteeing of accounts or selling are negligible or merely incidental, and unless no appreciable part of the earnings is to be ascribed to such activities. See also (e) below relating to the employment of capital.

(d) *Shareholders regularly engaged in the active conduct of the affairs of the corporation.* A corporation is not a personal service corporation unless shareholders who own at all times during the taxable year at least 70 percent in value of each class of stock are regularly engaged in the active conduct of the affairs of the corporation. That such shareholders devote some of their time to the affairs of the corporation is not sufficient; they must with regularity devote substantial time and energy to the conduct of its affairs.

(e) *Capital as a material income-producing factor.* In a personal service corporation capital must not be a material income-producing factor. Whether capital is a material income-producing factor is to be determined by reference to (1) the extent to which capital is required to carry on the business or profession and (2) the extent to which capital is actually used in the production of income though not required by the primary activities of the corporation. If the use of capital is necessary to the production of the income of the corporation and is more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. If a substantial portion of the income is attributable to a use of capital, whether or not connected with the primary activities of the corporation, capital is a material income-producing factor even though such use of capital is not necessary to such primary activities. The term "capital" as used in section 725 and in this section means not only capital actually invested by the shareholders but also capital obtained in other ways. Thus, capital may be borrowed either directly as shown by bonds, debentures, certificates of indebtedness, notes, bills payable, or other paper, or indirectly as shown by accounts payable or other forms of credit, or the business of the corporation may be financed in some other manner by its shareholders. If a substantial amount of capital is used to finance or carry the accounts of clients or customers, it will be inferred that because of competition or for other reasons such use of capital is necessary and more than incidental in order to secure or hold business which would otherwise be lost. If a corporation engaged in an agency, brokerage, or commission business regularly employs a substantial amount of capital to lend to its principals, to buy and carry goods on its own account, or to buy and carry odd lots in order that it may render more satisfactory service to its principals or customers, such corporation is not a personal service corporation. In general, the larger the amount of capital actually used the stronger is the evidence that capital is necessary and more than incidental and is a material income-producing factor.

The term "income" as used in section 725 and in this section means gross income. Capital is a material income-producing factor if its use results in a substantial amount of gross income, irrespective of the amount of net income, if any, such use produces.

(f) *Application of regulations; returns.* No definite and conclusive tests can be prescribed by which it can be

finally determined in advance of an examination of the corporation's income tax return whether it is or is not a personal service corporation. In the preceding subsections are set forth the general principles under which such determination will be made.

If a corporation claiming to be a personal service corporation signifies in its return under Chapter 1 for any taxable year its desire not to be subject to the excess profits tax under Subchapter E of Chapter 2 for such taxable year, it shall attach Form 1121PS, in duplicate, to its income tax return on Form 1120. In Form 1121PS there shall be stated (1) such facts as tend to show whether or not the corporation is a personal service corporation, including (i) the nature of its business, (ii) the character, preferences, dividend rates, and other essential features of the various classes of its stock outstanding for any time during the taxable year, (iii) the names and addresses of its several shareholders and their relationship to each other, (iv) the number and classes of shares owned at any time during the taxable year by each shareholder and the portion of the year during which such shares were so owned, (v) the nature of the activities of the several shareholders on behalf of the corporation, and (vi) the extent to which capital in any form is used in the business, and (2) the computation of the undistributed Supplement S net income for the taxable year, the names and addresses of all shareholders of the corporation at the close of the taxable year, the number and classes of shares held by each, and such other information as may be required by the form and the instructions printed on the form or issued therewith.

§ 35.725–3 *Election as to taxability.* The election as to taxability provided for in section 725 (b) and the exemption from tax, where such is allowable, have application only to the excess profits tax on domestic corporations imposed under Subchapter E of Chapter 2. The corporation may make such an election by signifying in its return under Chapter 1 its desire not to be subject to the excess profits tax. A new election is required for each taxable year. An amended return filed after the statutory period for filing the return (or after the last day of any extension period) is not a return within the meaning of section 725 (b).

SEC. 726. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936. [Added by sec. 201, Second Rev. Act 1940.]

(a) If the United States Maritime Commission certifies to the Commissioner that the taxpayer has completed within the taxable year any contracts or subcontracts which are subject to the provisions of section 505 (b) of the Merchant Marine Act of 1936, as amended, then the tax imposed by this subchapter for such taxable year shall be, in lieu of a tax computed under section 710, a tax computed under subsection (b) of this section, if, and only if, the tax computed under subsection (b) is less than the tax computed under section 710.

(b) The tax computed under this subsection shall be the excess of—

(1) A tentative tax computed under section 710 with the normal-tax net income increased by the amount of any payments made, or to be made, to the United States Maritime Commission with respect to such contracts or subcontracts; over

(2) The amount of such payments.

§ 35.726–1 *Corporations completing contracts under Merchant Marine Act of 1936.* (a) Section 726 provides for an alternative tax in the case of a corporation which has been certified by the United States Maritime Commission (hereinafter referred to as the Commission) to the Commissioner as having completed within the taxable year any contracts or subcontracts subject to the provisions of section 505 (b) of the Merchant Marine Act of 1936, as amended (hereinafter referred to as section 505 (b)). Under section 505 (b) a contractor or subcontractor is required to pay to the Commission the amount of profit, if any, in excess of 10 percent of the total contract prices of such contracts or subcontracts.

(b) The alternative tax is in lieu of the excess profits tax computed under section 710 but only if such alternative tax is less than the tax under such section. Such alternative tax is the excess of (1) a tentative tax computed under section 710 with the normal-tax net income increased by the amount of any payments made, or to be made, to the Commission with respect to contracts or subcontracts the completion of which during the taxable year has been certified to the Commissioner by the Commission, over (2) the amount of such payments. The tentative tax under section 726 (b) (1), as is the case with respect to the tax computed under section 710, shall be the lesser of:

(1) An amount equal to 90 percent of the adjusted excess profits net income (section 710 (a) (1) (A)), or

(2) An amount which when added to the sum of the normal tax and surtax for the taxable year equals 80 percent of the corporation surtax net income computed under section 15 (a) but without regard to the credit under section 26 (e) for income subject to excess profits tax (section 710 (a) (1) (B)).

If the tentative tax is computed under section 710 (a) (1) (B) and clause (2) of the immediately preceding sentence, the normal tax and surtax for such purposes shall be the actual normal tax and surtax computed under Chapter 1 and shall be determined by using as the credit under section 26 (e), in computing normal tax net income and corporation surtax net income, the amount of which the tax computed under section 726 (b) pursuant to the provisions of section 710 (a) (1) (A) is 90 percent. The corporation surtax net income for the purposes of section 710 (a) (1) (B) and clause (2) above, computed without regard to the credit under section 26 (e) for income subject to excess profits tax, shall be increased by the amount of any payments made, or to be made, to the United States Maritime Commission with respect to contracts or subcontracts subject to the provisions of section 505 (b). For the computation of tax under section 710 (a) (1) (B), see § 35.710–4 (c).

If the excess profits tax is computed for a taxable year of less than 12 months, the tentative tax shall be the excess profits tax for such taxable year computed under section 711 (a) (3) (see § 35.711 (a)–4), except that for such purpose the corporation surtax net income used to determine the tax under section 710 (a) (1) (B) shall be increased by the amount of any payments made, or to be made, to the United States Maritime Commission with respect to contracts or subcontracts subject to the provisions of section 505 (b).

The application of this paragraph may be illustrated by the following example:

For the calendar year 1942, Corporation S has a normal tax net income, and corporation surtax net income of $300,000, an excess profits net income of $330,000, and an excess profits credit of $75,000. It has paid to the United States Maritime Commission with respect to contracts completed in 1942 and subject to section 505 (b) of the Merchant Marine Act of 1936, as amended, $40,000. Its excess profits tax is $210,222.23, computed as follows:

Excess profits tax under section 710		
1. Excess profits net income		$330,000.00
2. Less specific exemption	$5,000.00	
3. Excess profits credit	75,000.00	
4. Item 2 plus item 3		80,000.00
5. Adjusted excess profits net income (item 1 minus item 4)		250,000.00
6. 90 percent of item 5		225,000.00
7. Corporation surtax net income computed without regard to credit under section 26 (e) relating to income subject to excess profits tax		300,000.00
8. 80 percent of item 7		240,000.00
9. Total normal tax and surtax (item 15)		20,000.00
10. Item 8 minus item 9		220,000.00
11. Excess profits tax (item 6 or item 10 whichever is lesser)		220,000.00
Normal tax and surtax		
12. Normal tax net income and corporation surtax net income computed without regard to credit under section 26 (e)		$300,000.00
13. Less credit under section 26 (e) (amount of which item 6 is 90 percent, i. e., item 5)		250,000.00
14. Normal tax net income and corporation surtax net income		50,000.00
15. Total normal tax and surtax (40 percent of item 14)		20,000.00

Excess profits tax under section 726 (b)

16. Excess profits net income including payment to Maritime Commission		$370,000.00
17. Less specific exemption	$5,000.00	
18. Excess profits credit	75,000.00	
19. Item 17 plus item 18		80,000.00
20. Adjusted excess profits net income		290,000.00
21. Tentative excess profits tax under section 726 (b) (1) and section 710 (a) (1) (A) (90 percent of item 20)		261,000.00
22. Less payments made to Maritime Commission		40,000.00
23. Excess profits tax under section 726 (b) and section 710 (a) (1) (A)		221,000.00
24. Corporation surtax net income including payment to Maritime Commission		340,000.00
25. 80 percent of item 24		272,000.00
26. Total normal tax and surtax (item 35)		21,777.77
27. Tentative excess profits tax under section 726 (b) (1) and section 710 (a) (1) (B) (item 25 minus item 26)		250,222.23
28. Less payments made to Maritime Commission		40,000.00
29. Excess profits tax under section 726 (b) and section 710 (a) (1) (B)		210,222.23
30. Excess profits tax under section 726 (b) (item 29 or item 23 whichever is the lesser)		210,222.23
31. Excess profits tax under section 726 (item 11 or item 30 whichever is the lesser)		210,222.23

Normal tax and surtax for item 26

32. Normal tax net income and corporation surtax net income (item 12)		$300,000.00
33. Less credit under section 26 (e) (amount of which $221,000, item 23, is 90 percent)		245,555.56
34. Normal tax net income and corporation surtax net income		54,444.44
35. Normal tax and surtax (40 percent of item 34)		21,777.77

(c) For the purposes of section 726, a certificate by the Commission that the vessel or portion thereof covered by the contract or subcontract has been delivered during the taxable year shall be deemed to be the certificate required by such section.

(d) A corporation claiming the benefit of section 726 shall attach to its excess profits tax return (1) a certificate of the Commission showing each contract or subcontract subject to the provisions of section 505 (b) which the corporation has completed within the taxable year and (2) a statement showing the amount of payments made, or to be made, to the Commission with respect to such contracts and subcontracts. If the amount of the payments made, or to be made, to the Commission with respect to such contracts or subcontracts has not been ascertained at the time of filing the excess profits tax return, the corporation may estimate the amount of such payments for the purposes of section 726. In such cases, the Commissioner may require a bond from the corporation as a condition precedent to the computation of the tax under that section. If such a bond is required, it shall be on the form prescribed by the Commissioner and in such sum as the Commissioner may prescribe, and it shall be conditioned upon the payment by the corporation of any amount of tax found due upon redetermination of the tax made necessary by the estimated amount under section 726 (b) (2) proving incorrect, and upon such further conditions as the Commissioner may require. The bond shall be executed by the corporation as principal and by sureties satisfactory to the Commissioner. (See also section 1126 of the Revenue Act of 1926, as amended, paragraph 63 of the Appendix to Part 29 of this chapter.)

(e) If the amount actually paid, or to be paid, to the Commission under section 505 (b) differs from the amount used in determining the tax under section 726, the corporation shall immediately notify the Commissioner of the amount actually paid, or to be paid, with respect to the particular contract. The Commissioner will thereupon redetermine the amount of the excess profits tax under section 726, and the amount of tax, if any, found to be due upon such redetermination shall be paid by the corporation upon notice and demand from the collector. The amount of tax, if any, shown upon redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 322.

SEC. 727. EXEMPT CORPORATIONS. [Added by sec. 201, Second Rev. Act 1940; amended by secs. 212 (b) and 223 (a) and (c), Rev. Act 1942.]

The following corporations, except a member of an affiliated group of corporations filing consolidated returns under section 141, shall be exempt from the tax imposed by this subchapter:

(a) Corporations exempt under section 101 from the tax imposed by Chapter 1.

(b) Foreign personal-holding companies, as defined in section 331.

(c) Regulated investment companies as defined in section 361 without the application of section 361 (b) (4).

(e)[1] Personal-holding companies, as defined in section 501.

(f) Foreign corporations not engaged in trade or business within the United States.

(g) Domestic corporations satisfying the following conditions:

(1) If 95 per centum or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

(2) If 50 per centum or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

(h) Any corporation subject to the provisions of Title IV of the Civil Aeronautics Act of 1938, in the gross income of which for any taxable year beginning after December 31, 1939, there is includible compensation received from the United States for the transportation of mail by aircraft if, after excluding from its gross income such compensation, its adjusted excess profits net income for such year is zero or less.

§ 35.727–1 *Exempt corporations.* (a) A corporation which has established its right under section 101 to exemption from income tax need not again establish its right under section 727 (a) to exemption from excess profits tax. A corporation which has not established its right to exemption under section 101 and which claims exemption under section 727 (a) is required to establish its right to exemption under section 101 in the manner prescribed in the regulations thereunder in order to be held exempt under section 727 (a).

(b) A corporation which claims exemption under the provisions of section 727, other than the provisions of section 727 (a), (g), and (h), shall file with its income tax return a statement showing under what paragraph of section 727 it claims exemption.

(c) A corporation which claims exemption under section 727 (g) shall attach to its income tax return a statement showing for the 3-year period immediately preceding the close of the taxable year (or for such part thereof during which the corporation was in existence) (1) its total gross income from all sources, (2) the amount thereof derived from the active conduct of a trade or business, (3) a description of such trade or business and the facts upon which the corporation relies to establish that such trade or business was actively conducted by it, and (4) the amount of its gross income from sources within the United States. The gross income from sources within the United States shall be determined as provided in section 119 and the regulations prescribed thereunder.

(d) A corporation which claims exemption under section 727 (h) shall attach to its income tax return a statement showing (1) that it is subject to the provisions of Title IV of the Civil Aeronautics Act of 1938, (2) the amount of the compensation included in the gross income of the corporation as compensation received from the United States for the

[1] No subsection (d).

transportation of mail by aircraft, and (3) the amount of its gross income, net income, excess profits net income, and adjusted excess profits net income, after excluding from its gross income the amount of such compensation.

(e) If any corporation described in subsection (a), (b), (c), (e), (f), (g), or (h) of section 727 is a member of an affiliated group of corporations filing consolidated returns under section 141, such corporation shall not be exempt under section 727 for such year.

As to the statute of limitations where no return is filed, see sections 275 (a) and 276 (a).

SEC. 728. MEANING OF TERMS USED. [Added by sec. 201, Second Rev. Act 1940.]

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

SEC. 729. LAWS APPLICABLE. [Added by sec. 201, Second Rev. Act 1940; Amended by sec. 16, Excess Profits Tax Amendments 1941, and by secs. 205 (g), 224 (a), and 225 (b), Rev. Act 1942.]

(a) *General rule.* All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

(b) *Returns.* (1) [Not applicable to taxable years under these regulations (section 224 (a), Rev. Act 1942).]

(2) *No return required.* Notwithstanding subsection (a), no return under section 52 (a) shall be required to be filed by any taxpayer under this subchapter for any taxable year for which its excess profits net income, computed with the adjustments provided in section 711 (a) (2) and placed on an annual basis as provided in section 711 (a) (3), is not greater than $5,000 or, in the case of a mutual insurance company (other than life or marine) which is an interinsurer or reciprocal underwriter, is not greater than $50,000.

(3) *Consolidated returns.* For provisions relating to consolidated returns, see section 141.

(c) *Foreign taxes paid.* In the application of section 131 for the purposes of this subchapter the tax paid or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed with respect to such tax against the tax imposed by Chapter 1.

(d) *Limitations on amount of foreign tax credit.* The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources within said country bears to its entire excess profits net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources without the United States bears to its entire excess profits net income for the same taxable year.

§ 35.729–1 *Time and place for filing returns and information to be included.* Excess profits tax returns shall be filed at the same time and place as the time and place prescribed in sections 53 and 235 and the income tax regulations under such sections for the filing of income tax returns. The excess profits tax return of a corporation of income received or accrued:

(a) From the date of its incorporation to the end of its first accounting period, where the period between the date of incorporation and the end of such period is less than 12 months, or

(b) From the beginning of its last accounting period to the date it ceases operations and is dissolved, retaining no assets, where the period between the beginning of the accounting period and such date is less than 12 months,

shall be considered as a return for a fractional part of a year consisting of such period, and shall be filed within the time prescribed for filing returns for taxable years of less than 12 months.

The excess profits tax return shall be on Form 1121 (revised), and such return shall contain all the information required by such form and by these regulations with respect to computation of such tax. The return, however, requires the computation of the tax with only the credit which results in the lesser tax, and a return so filed meets the requirements of the statute. Thus a taxpayer may omit from the return the computation and information with respect to the excess profits credit under section 713 or section 714 which does not result in the lesser excess profits tax and may omit the computation and information with respect to the excess profits net income otherwise to be computed with such omitted credit. A return filed in this manner shall be audited as filed, regardless of whether it may be determined that the use of the omitted credit would result in a lesser tax. A corporation which files a return is not, by reason of the fact that only one method of computing its credit is employed, precluded from using the other method in the computation of its excess profits tax for such taxable year and, if an overpayment results, from filing a claim for the refund of such overpayment within the applicable period of limitation.

For provisions relating to consolidated returns, see section 141 and the regulations prescribed thereunder.

§ 35.729–2 *Time for payment of tax.* The excess profits tax shall be paid at the same time as the time prescribed in sections 56 and 236 and the income tax regulations under such sections for the payment of income tax.

§ 35.729–3 *Foreign tax credit.* The provisions of law made applicable to the excess profits tax by section 729 (a) include section 131 relating to the credit for income, war-profits and excess-profits taxes paid or accrued during the taxable year to any foreign country or any possession of the United States. The taxpayer is allowed such a credit against the excess profits tax if it claims such credit in its Federal income tax return and likewise claims such credit in its excess profits tax return. The amount of such credit allowable against the excess profits tax is (a) the amount of such income, war-profits and excess-profits taxes reduced by (b) the amount of such taxes allowed as a credit under section 131 against the income tax. Thus, for instance, if a taxpayer pays to a foreign country with respect to the calendar year 1942 income tax in the amount of $25,000 upon income from sources therein and, due to the operation of the limitation provisions, contained in section 131 (b), only the amount of $20,000 is allowed as a credit against the income tax for that year, the remainder, or $5,000, is available as a credit against the excess profits tax for the year 1942. The amount thus made available as a credit against the excess profits tax is, however, subject to the further limitations provided in section 729 (d). For the application of the limitations provided in section 729 (d) to the amount of income, war-profits or excess-profits taxes thus made available as a credit against the excess profits tax, see section 131 (b) and the regulations prescribed thereunder.

SEC. 730. CONSOLIDATED RETURNS. [Added by sec. 201, Second Rev. Act. 1940; amended by sec. 7, Excess Profits Tax Amendments 1941, and by sec. 225(a), Rev. Act 1942; not applicable to taxable years under these regulations (sec. 225(a), Rev. Act 1942).]

SEC. 731. CORPORATIONS ENGAGED IN MINING OF STRATEGIC MINERALS. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 204, Rev. Act 1941, and by sec. 226, Rev. Act 1942.]

In the case of any domestic corporation engaged in the mining of antimony, chromite, manganese, nickel, platinum, quicksilver, sheet mica, tantalum, tin, tungsten, or vanadium, the portion of the adjusted excess profits net income attributable to such mining in the United States shall be exempt from the tax imposed by this subchapter. The tax on the remaining portion of such adjusted excess profits net income shall be an amount which bears the same ratio to the tax computed without regard to this section as such remaining portion bears to the entire adjusted excess profits net income.

§ 35.731–1 *Corporations which mine strategic minerals.* (a) In case a domestic corporation is engaged in mining tungsten, quicksilver, manganese, platinum, antimony, chromite, tin, nickel, sheet mica, tantalum, or vanadium (all of which minerals are hereinafter referred to as strategic minerals), within the United States, the portion of its adjusted excess profits net income attributable to such mining is exempt from excess profits tax. The excess profits tax on the remaining portion of such adjusted excess profits net income is an amount which bears the same ratio to the excess profits tax computed without regard to section 731 as such remaining portion bears to the entire adjusted excess profits net income. The excess profits tax shall be the lesser of:

(1) An amount equal to 90 percent of the adjusted excess profits net income (section 710(a)(1)(A)), or

(2) An amount which when added to the sum of the normal tax and surtax for the taxable year equals 80 percent of the corporation surtax net income computed under section 15(a) but without regard to the credit under section 26 (e) for income subject to excess profits tax (section 710(a)(1)(B)). If the excess profits tax computed without regard to section 731 is determined under section 710 (a) (1) (B) and clause (2) of this paragraph, the normal tax and surtax for such purposes shall be determined by using as the credit under section 26(e) in computing normal tax net income and corporation surtax net income the amount of which the tax computed pursuant to section 710(a)(1)(A) and under section 731 upon the adjusted excess

profits net income other than from mining strategic minerals is 90 percent.

(b) The portion of the adjusted excess profits net income attributable to mining of strategic minerals is an amount which bears the same ratio to the total adjusted excess profits net income as the portion of the excess profits net income attributable to such mining bears to the total excess profits net income. For any taxable year, the portion of the excess profits net income attributable to such mining is the gross income derived from strategic minerals and arising out of operations which give rise to "gross income from the property," as defined in § 29.23 (m)–1 (f) of this chapter, less the sum of (1) allowable deductions which are directly attributable to such mining for such year, (2) any adjustments made under the provisions of section 711 applicable to such year involving items directly attributable to such mining, and (3) an allocable portion of any deductions partly attributable to such mining and of any adjustments under the provisions of section 711 applicable to such year involving items partly attributable to such mining.

(c) There shall be attached to and made a part of the return of any taxpayer claiming the benefits under section 731 a schedule containing the following information:

(1) The amount of gross income from the mining of strategic minerals and from each other activity of the corporation;

(2) The allowable deductions and the adjustments under section 711 directly attributable to such mining; and

(3) The portion of the allowable deductions and of the adjustments under section 711 allocated to such mining and the basis for such allocation.

The following example illustrates the computation of the tax in the case of a corporation entitled to the benefits of section 731:

Example. The M Corporation, a domestic corporation which makes its return on a calendar year basis, mines both gold and platinum (a by-product of gold) and reduces the ores containing such metals. For 1942, the corporation has an excess profits credit of $40,000. Also for 1942 the excess profits net income of the M Corporation attributable to platinum mining is $40,000; that attributable to other activities is $180,000. The normal tax net income and corporation surtax net income computed without regard to the credit under section 26 (e) for income subject to excess profits tax is $200,000. The excess profits tax is $112,314.05, computed as follows:

1. Total excess profits net income		$220,000.00
2. Less specific exemption	$5,000.00	
3. Excess profits credit	40,000.00	
4. Item 2 plus item 3		45,000.00
5. Adjusted excess profits net income		175,000.00
6. Less portion attributable to platinum mining $\left(\frac{40,000}{220,000}\text{ of }\$175,000\right)$		31,818.18
7. Remaining portion of adjusted excess profits net income		143,181.82
8. Excess profits tax on adjusted excess profits net income computed without regard to section 731 (90 percent of item 5)		157,500.00
9. Excess profits tax pursuant to section 710 (a) (1) (A) under section 731 on item 7, i. e., portion of item 8 which bears the same ratio to $157,500 (item 8) as portion of adjusted excess profits net income not attributable to platinum mining (item 7) bears to total adjusted excess profits net income (item 5) $\left(\frac{143,181.82}{175,000}\text{ of }\$157,500\right)$ (viz, 90 percent of item 7)		128,863.64
10. Corporation surtax net income computed without credit under section 26 (e) for income subject to excess profits tax		200,000.00
11. 80 percent of item 10		160,000.00
12. Total normal tax and surtax (item 19)		22,727.27
13. Item 11 minus item 12		137,272.73
14. Excess Profits tax pursuant to section 710(a)(1)(B) under section 731 on item 7, i. e., portion of item 13 which bears the same ratio to $137,272.73 (item 13) as portion of adjusted excess profits net income not attributable to platinum mining (item 7) bears to total adjusted excess profits net income (item 5) $\left(\frac{143,181.82}{175,000}\text{ of }\$137,272.73\right)$		112,314.05
15. Excess profits tax under section 731 on portion of adjusted excess profits net income not attributable to platinum mining (item 7) (item 9 or item 14, whichever is the lesser)		112,314.05
Normal tax and surtax		
16. Normal tax net income and corporation surtax income computed without regard to credit under section 26(e) for income subject to excess profits tax		200,000.00
17. Less credit under section 26(e) for income subject to excess profits tax (an amount of which the excess profits tax under section 731 computed without regard to section 710(a)(1)(B) is 90 percent, i. e., an amount of which $128,863.64 (item 9) is 90 percent (viz, item 7)		143,181.82
18. Normal tax net income and corporation surtax net income		56,818.18
19. Total normal tax and surtax (40 percent of item 18)		22,727.27

SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX APPEALS. [Added by sec. 9, Excess Profits Tax Amendments 1941; amended by sec. 222(c), Rev. Act 1942.]

(a) *Petition to the Board.* If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Board of Tax Appeals, for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) *Deficiency found by Board in case of claim.* If the Board finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Board further finds that there is a deficiency for such year, the Board shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Board becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) *Finality of determination.* If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board.

(d) *Review by special division of Board.* The determinations and redeterminations by any division of the Board involving any question arising under section 721 (a) (2) (C) or section 722 shall be reviewed by a special division of the Board which shall be constituted by the Chairman and consist of not less than three members of the Board. The decisions of such special division shall not be reviewable by the Board, and shall be deemed decisions of the Board.

SEC. 504. CHANGE OF NAME OF BOARD OF TAX APPEALS. (Revenue Act of 1942, Title V.)

* * * * * *

(c) *References.* All references in any statute (except this section), or in any rule, regulation, or order, to the "Board of Tax Appeals" or to the "Board" when used in the sense of "Board of Tax Appeals", or to the "member", "members", or "chairman" thereof shall be considered to be made to The Tax Court of the United States, the judge, judges, and presiding judge thereof, respectively.

§ 35.732–1 *Review of abnormalities by The Tax Court of the United States.* Section 732 provides that, in addition to its jurisdiction to redetermine a deficiency, The Tax Court of the United States shall have jurisdiction to review the Commissioner's disallowance of a claim for refund of excess profits taxes, if such disallowance involves the determination of any question relating solely to the application of section 711 (b) (1) (H), (I), (J), or (K), relating to abnormal deductions during the base period, section 721, relating to abnormalities in income in the taxable period, or section 722, relating to general relief from excessive and discriminatory excess profits taxes. The taxpayer's petition must be filed with The Tax Court within

90 days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) after the sending by registered mail of the notice of disallowance of the claim for refund.

Where the taxpayer has filed such a petition the notice of disallowance of its claim for refund is considered to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments. If The Tax Court finds that there has been no overpayment of tax with respect to the taxable year involved, and further finds that there is a deficiency for such year, The Tax Court will determine the amount of such deficiency and such amount shall, when the decision of The Tax Court becomes final, be assessed and paid upon notice and demand from the collector.

The extent and the finality of The Tax Court's jurisdiction with respect to questions involving the sections dealing with abnormalities and general excess profits tax relief are set forth in section 732 (c) and (d). If the ascertainment of the excess profits tax liability for a taxable year is dependent in whole or in part upon the determination of any question which is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except The Tax Court. If the determinations and redeterminations by any division of The Tax Court involve any question arising under section 721 (a) (2) (C) or section 722, such determinations and redeterminations shall be reviewed by a special division of The Tax Court which shall be constituted by the presiding judge and shall consist of not less than three judges of The Tax Court. The decisions of such special division shall not be reviewable by The Tax Court, or by any court or agency, and shall be deemed decisions of The Tax Court. The application of section 732 (c) and (d) may be shown by the following example:

Example. A taxpayer, which is a domestic manufacturing corporation, has filed a claim for refund for a taxable year beginning in 1942, and as a result of the Commissioner's action with respect to such claim, makes the following contentions: first, that it is entitled to a constructive average base period net income of $1,300,000 pursuant to an application filed on Form 991 for relief under section 722 instead of a constructive average base period net income of $900,000 determined by the Commissioner; second, that $100,000 of income from a judgment based upon a claim for patent infringement is net abnormal income attributable under section 721 to prior years whereas the Commissioner has attributed only $60,000 to such years; and third, that the amount of gross income determined by the Commissioner is too large. Since the taxpayer's first contention is predicated upon an issue arising under section 722, the Commissioner's determination is reviewable only by The Tax Court, and any determination or redetermination made by any division of The Tax Court must be reviewed by the special division constituted by the presiding judge; the decision of such special division is the decision of The Tax Court and cannot be reviewed by The Tax Court or any court or agency. The taxpayer's second contention is based upon an issue arising under section 721; therefore the Commissioner's determination is reviewable only by The Tax Court. Since the issue arises under section 721 (a) (2) (A), and not section 721 (a) (2) (C), no further review is required by the special division, and the decision of The Tax Court is final and cannot be reviewed by any court or agency. The taxpayer's third contention does not arise under either section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, but independently of such sections. Consequently review of this issue is not confined to The Tax Court.

SEC. 733. CAPITALIZATION OF ADVERTISING, ETC., EXPENDITURES. [Added by sec. 10, Excess Profits Tax Amendments 1941.]

(a) *Election to charge to capital account.* For the purpose of computing the excess profits credit, a taxpayer may elect, within six months after the date prescribed by law for filing its return for its first taxable year under this subchapter, to charge to capital account so much of the deductions for taxable years in its applicable base period on account of expenditures for advertising or the promotion of good will, as, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, may be regarded as capital investments. Such election must be the same for all such taxable years, and must be for the total amount of such expenditures which may be so regarded as capital investments. In computing the excess profits credit, no amount on account of such expenditures shall be charged to capital account:

(1) For taxable years in the base period unless the election authorized in subsection (a) is exercised, or

(2) For any taxable year prior to the beginning of the base period.

(b) *Effect of election.* If the taxpayer exercises the election authorized under subsection (a)—

(1) The net income for each taxable year in the base period shall be considered to be the net income computed with such deductions disallowed, and such deductions shall not be considered as having diminished earnings and profits. This paragraph shall be retroactively applied as if it were a part of the law applicable to each taxable year in the base period; and

(2) The treatment of such expenditures as deductions for a taxable year in the base period shall, for the purposes of section 734 (b) (2), be considered treatment which was not correct under the law applicable to such year.

§ 35.733–1 *Scope of election to charge to capital account expenditures for advertising or the promotion of good will.* Any taxpayer may, for the purpose of computing its excess profits credit under either the income or the invested capital method, elect to charge to capital account any deductions based upon expenditures for taxable years in its base period on account of advertising or the promotion of good will, to the extent that such expenditures may be regarded as capital investments under the regulations prescribed under section 733. Section 733 provides for an election with reference only to deductions for such expenditures for taxable years in the base period. In order to secure the benefits of that section an election must be made by the taxpayer within six months after the date prescribed by law for filing its return for its first excess profits tax taxable year under Subchapter E of Chapter 2.

The election under section 733 is an election to capitalize all the expenditures in each taxable year in the taxpayer's base period which were for advertising or the promotion of good will and which may be regarded as capital investments under the regulations prescribed under section 733. A taxpayer may not capitalize such expenditures for one base period taxable year and treat as a deduction such expenditures with respect to another base period taxable year. No such expenditures for any taxable year beginning prior to the taxpayer's base period may be charged to capital account. A taxpayer which has failed to make an election under section 733 is not permitted, in computing its excess profits credit, to charge to capital account base period expenditures for advertising or the promotion of good will which have been deducted for taxable years in such period.

§ 35.733–2 *Expenditures which may be regarded as capital investments.* An expenditure for advertising or the promotion of good will may be regarded as a capital investment if, upon consideration of all the facts and circumstances of the particular case, it may be regarded as made for the purpose of increasing the taxpayer's earning capacity over a substantial period subsequent to the taxable year in which such expenditure was made. The fact that a corporation failed, because of operating losses, to receive any benefits with respect to its income tax liability from deductions on account of expenditures is not evidence that such expenditures may be regarded as capital investments. In addition to those expenditures for capital items including good will which, under the provisions of section 24, may not be allowed as deductions, the following expenditures may in any case be regarded as capital investments within the contemplation of section 733:

(a) All advertising expenditures to promote a taxpayer's business in a territory new to such taxpayer, or to promote a new product, department, trade mark, trade brand, or trade name of such taxpayer, for the first 12 months after the taxpayer has begun to develop such new territory, or to promote such new product, department, trade mark, trade brand, or trade name. A new product within the meaning of this section does not include any product which is merely an improvement of an earlier product.

(b) All advertising expenditures for the taxable year to the extent that such expenditures exceed the taxpayer's average annual expenditures on account of advertising for the 48 months preceding the taxable year, or, if the taxpayer was not in existence during the whole of such 48-month period, then for the period during which the taxpayer was in existence.

Every item classifiable under this section as a capital investment constitutes a permanent asset of the taxpayer's business, and no deduction for depreciation will be allowed in respect of such an item.

A taxpayer which has made the election under section 733 may not deduct for any excess profits tax taxable year expenditures made in such year similar to expenditures made during its base period for advertising or the promotion of good will which are treated under sec-

tion 733 for the purposes of its excess profits credit as capital investments. Such a taxpayer has the burden of proving that expenditures for advertising or the promotion of good will which it seeks to deduct for such excess profits tax taxable year may not be regarded as capital investments under the provisions of this section. The taxpayer shall submit with its excess profits tax return a statement containing complete information with respect to all expenditures for advertising or the promotion of good will made during its excess profits tax taxable year, classified as to those which are deductible and those which may be regarded as capital investments under section 733. The statement filed with the return shall also set forth whether such expenditures were extraordinary in nature or amount and the purpose for which they were made.

§ 35.733–3 *Effect of election.* Section 733 retroactively amends, for the purpose of determining the income tax liability and the excess profits credit of any taxpayer exercising an election under that section, the revenue laws applicable to each of such taxpayer's base period taxable years. Hence, the previous treatment as deductions of expenditures made during the base period for advertising or the promotion of good will which may be regarded as capital investments under the regulations prescribed under section 733 is an erroneous and inconsistent treatment. The normal-tax or special-class net income for each applicable base period taxable year must be recomputed with such expenditures disallowed as deductions, and both the excess profits net income for each such year and the earnings and profits account will be increased in the amount of such disallowed deductions.

The disallowance of deductions in the base period made necessary by this section requires a redetermination of the income tax liability for such years and any deficiencies in tax resulting from the disallowance of such deductions shall be assessed and collected under the internal revenue laws applicable with respect to the assessment and collection of deficiencies for such years. If, however, correction of the effect of the prior inconsistent treatment of such items in the base period years is prevented, within the meaning of section 734 (b) (1) (C), correction shall be made by means of an adjustment under section 734. Since the amount of such an adjustment under section 734 is a part of the excess profits tax, which applies only to taxable years beginning after December 31, 1939, it does not decrease earnings and profits or excess profits net income for any period before the beginning of the taxpayer's first excess profits tax taxable year.

In the case of a taxpayer electing under section 733, the provisions of section 711 (b) (1) (J), relating to abnormal deductions in the base period, do not affect deductions for expenditures for advertising or the promotion of good will which may be regarded as capital investments, since, in such a case, section 733 effects a disallowance of such deductions for income tax purposes before any of the adjustments under section 711 (b) (1) are operative.

SEC. 734. ADJUSTMENT IN CASE OF POSITION INCONSISTENT WITH PRIOR INCOME TAX LIABILITY. [Added by sec. 11, Excess Profits Tax Amendments 1941; amended by sec. 227, Rev. Act 1942.]

(a) *Definitions.* For the purposes of this section—

(1) *Taxpayer.* The term "taxpayer" means any person subject to a tax under the applicable revenue Act.

(2) *Income tax.* The term "income tax" means an income tax imposed by Chapter 1 or Chapter 2A of this title; Title I and Title IA of the Revenue Acts of 1938, 1936, and 1934; Title I of the Revenue Acts of 1932 and 1928; Title II of the Revenue Acts of 1926 and 1924; Title II of the Revenue Acts of 1921 and 1918; Title I of the Revenue Act of 1917; Title I of the Revenue Act of 1916; or section II of the Act of October 3, 1913; a war profits or excess profits tax imposed by Title III of the Revenue Acts of 1921 and 1918; or Title II of the Revenue Act of 1917; or an income, war profits, or excess profits tax imposed by any of the foregoing provisions, as amended or supplemented.

(3) *Prior taxable year.* A taxable year beginning after December 31, 1939, shall not be considered a prior taxable year.

(4) The term "predecessor of the taxpayer" means—

(A) A person which is a component corporation of the taxpayer within the meaning of section 740; and

(B) A person which on April 1, 1941, or at any time thereafter, controlled the taxpayer. The term "controlled" as herein used shall have the same meaning as "control" under section 112 (h), and

(C) Any person in an unbroken series ending with the taxpayer if subparagraph (A) or (B) would apply to the relationship between the parties.

(b) *Circumstances of adjustment.*

(1) If—

(A) in determining at any time the tax of a taxpayer under this subchapter an item affecting the determination of the excess profits credit is treated in a manner inconsistent with the treatment accorded such item in the determination of the income-tax liability of such taxpayer or a predecessor for a prior taxable year or years, and

(B) the treatment of such item in the prior taxable year or years consistently with the determination under this subchapter would effect an increase or decrease in the amount of the income taxes previously determined for such taxable year or years, and

(C) on the date of such determination of the tax under this subchapter correction of the effect of the inconsistent treatment in any one or more of the prior taxable years is prevented (except for the provisions of section 3801) by the operation of any law or rule of law (other than section 3761, relating to compromises),

then the correction shall be made by an adjustment under this section. If in a subsequent determination of the tax under this subchapter for such taxable year such inconsistent treatment is not adopted, then the correction shall not be made in connection with such subsequent determination.

(2) Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the net effect of the adjustment would be a decrease in the income taxes previously determined for such year or years) or by the taxpayer with respect to whom the determination is made (in case the net effect of the adjustment would be an increase in the income taxes previously determined for such year or years) which position is inconsistent with the treatment accorded such item in the prior taxable year or years which was not correct under the law applicable to such year.

(3) *Burden of proof.* In any proceeding before the Board or any court the burden of proof in establishing that an inconsistent position has been taken (A) shall be upon the Commissioner, in case the net effect of the adjustment would be an increase in the income taxes previously determined for the prior taxable year or years, or (B) shall be upon the taxpayer, in case the net effect of the adjustment would be a decrease in the income taxes previously determined for the prior taxable year or years.

(c) *Method and effect of adjustment.* (1) The adjustment authorized by subsection (b), in the amount ascertained as provided in subsection (d), if a net increase shall be added to, and if a net decrease shall be subtracted from, the tax otherwise computed under this subchapter for the taxable year with respect to which such inconsistent position is adopted.

(2) If more than one adjustment under this section is made because more than one inconsistent position is adopted with respect to one taxable year under this subchapter, the separate adjustments, each an amount ascertained as provided in subsection (d), shall be aggregated, and the aggregate net increase or decrease shall be added to or subtracted from the tax otherwise computed under this subchapter for the taxable year with respect to which such inconsistent positions are adopted.

(3) If all the adjustments under this section, made on account of the adoption of an inconsistent position or positions with respect to one taxable year under this subchapter, result in an aggregate net increase, the tax imposed by this subchapter shall in no case be less than the amount of such aggregate net increase.

(4) If all the adjustments under this section, made on account of the adoption of an inconsistent position or positions with respect to a taxable year under this subchapter (hereinafter in this paragraph called the current taxable year), result in an aggregate net decrease, and the amount of such decrease exceeds the tax imposed by this subchapter (without regard to the provisions of this section) for the current taxable year, such excess shall be subtracted from the tax imposed by this subchapter for each succeeding taxable year, but the amount of the excess to be so subtracted shall be reduced by the reduction in tax for intervening taxable years which has resulted from the subtraction of such excess from the tax imposed for each such year.

(d) *Ascertainment of amount of adjustment.* In computing the amount of an adjustment under this section there shall first be ascertained the amount of the income taxes previously determined for each of the prior taxable years for which correction is prevented. The amount of each such tax previously determined for each such taxable year shall be (1) the tax shown by the taxpayer, or by the predecessor, upon the return for such prior taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpayer or such predecessor upon the return, or if no return was made by such taxpayer or such predecessor, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or decrease in each such tax previously determined for each such

year which results solely from the treatment of the item consistently with the treatment accorded such item in the determination of the tax liability under this subchapter. To the increase or decrease so ascertained for each such tax for each such year there shall be added interest thereon computed as if the increase or decrease constituted a deficiency or an overpayment, as the case may be, for such prior taxable year. Such interest shall be computed to the fifteenth day of the third month following the close of the excess profits tax taxable year with respect to which the determination is made. There shall be ascertained the difference between the aggregate of such increases, plus the interest attributable to each, and the aggregate of such decreases, plus the interest attributable to each, and the net increase or decrease so ascertained shall be the amount of the adjustment under this section with respect to the inconsistent treatment of such item.

(e) *Interest in case of net increase or decrease* (1) If an adjustment under this section results in a net decrease, or more than one adjustment results in an aggregate net decrease, the portion of such net decrease or aggregate net decrease, as the case may be, subtracted from the tax which represents interest shall be included in gross income of the taxable year in which falls the date prescribed for the payment of the tax under this subchapter.

(2) If an adjustment under this section results in a net increase, or more than one adjustment results in an aggregate net increase, the portion of such net increase or aggregate net increase, as the case may be, which represents interest shall be allowed as a deduction in computing net income for the taxable year in which falls the date prescribed for the payment of the tax under this subchapter.

§ 35.734–1 *Purpose and scope of section 734*—(a) *General.* Section 734 provides for an adjustment if a determination of a taxpayer's excess profits tax liability treats an item or transaction affecting the excess profits credit inconsistently with the treatment of such item or transaction in the determination of the income tax liability of the taxpayer, or a predecessor, for a prior taxable year or years. The adjustment is not authorized unless (1) the treatment of the item or transaction for prior taxable years was incorrect under the law applicable to such years, (2) a correction of the effect of such erroneous treatment for one or more of the prior taxable years is prevented by the operation of a provision or rule of law, and (3) the inconsistent position adopted in the determination is asserted and maintained by the party (either the Commissioner or the taxpayer) who would be adversely affected by the adjustment.

(b) *Definitions.* When used in §§ 35.734–1 to 35.734–4 inclusive:

(1) The terms "taxpayer," "income tax," and "prior taxable year" shall have the meaning assigned to such terms by section 734 (a). As to what constitutes a taxable year, see section 48 (a).

(2) The term "predecessor of the taxpayer" shall have the meaning assigned to such term by section 734 (a) (4). It is specifically provided that the term "controlled" as used in such definition shall have the same meaning as "control" under the definition contained in section 112 (h). Accordingly, a person is a predecessor of the taxpayer if, on April 1, 1941, or at any time thereafter, such person owned stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the taxpayer. For the purpose of section 734 it is immaterial that such control did not exist during the taxable year in respect of which the incorrect treatment of the item or transaction occurred, or during the taxable year in respect of which the inconsistent position is adopted in the determination of the excess profits credit of the taxpayer.

Any person which is a component corporation of the taxpayer under the definition contained in section 740 is a predecessor of the taxpayer within the meaning of section 734. Such person may be a corporation, partnership, or a sole proprietor. Any such component corporation is a predecessor of the taxpayer irrespective of the method employed in computing the excess profits credit of the taxpayer.

Under the terms of the definition, any person which is a predecessor of a predecessor in an unbroken series ending with the taxpayer is a predecessor of the taxpayer within the meaning of section 734.

The limitation of the term "predecessor of the taxpayer" to certain cases, and the resulting exclusion of other cases, should not be construed to affect the established judicial doctrines commonly known as estoppel, recoupment, set-off, etc., which may be applied by the courts in appropriate cases.

§ 35.734–2 *Circumstances of adjustment*—(a) *Determination.* A final determination of the excess profits tax liability is not a prerequisite to an adjustment under section 734. Whenever there is a determination of the excess profits tax liability and the conditions prescribed in section 734 (b) are satisfied, the adjustment is authorized as an essential part of the determination of such tax liability. For example, the making of the excess profits tax return required by section 729 or section 141 is a determination by the taxpayer; the assertion of a deficiency or the allowance or disallowance of a claim for refund is a determination by the Commissioner; and a decision by The Tax Court of the United States or a court is a determination by such Tax Court or court. If any such determination becomes final, the adjustment also becomes final. If, following a determination, there are further proceedings in the case and a subsequent determination which does not adopt the inconsistent treatment of the item or transaction, then no adjustment is authorized as a part of such subsequent determination.

(b) *Correction under ordinary procedure prevented.* An adjustment is authorized only if, on the date of the determination of the excess profits tax liability, correction of the effect of the inconsistent treatment for one or more of the prior taxable years is prevented (except for the provisions of section 3801, relating to mitigation of effect of limitations and other provisions in income tax cases) by the operation, whether before, on, or after the date of enactment of section 734, of any provision of law (other than section 3761, relating to compromises) or rule of law. Such provisions or rules of law include, for example, status of limitations and res judicata.

The ascertainment of whether correction of the effect of the inconsistent treatment is prevented within the meaning of section 734(b) (1) (C) and this section must be made with respect to each income tax for each prior taxable year affected by the erroneous treatment of the item or transaction. Section 734 is not applicable in respect of any income tax for any prior taxable year if, on the date of the determination of the excess profits tax liability, correction of the effect of the erroneous treatment of the item is possible under the ordinary procedure applicable to the assessment and collection of deficiencies or the refund or credit of overpayments, as the case may be, in respect of such tax for such taxable year. See the example under § 35.734–4.

If correction of the effect of the erroneous treatment of the item or transaction with respect to an income tax for a prior taxable year is otherwise prevented, the application of section 734 is not precluded by the fact that the tax for such year may, under appropriate circumstances, be open to an adjustment under section 3801.

If any income tax liability for a prior taxable year has been compromised under section 3761, no adjustment may be made under section 734 with respect to the tax liability compromised.

(c) *Operation dependent upon maintenance of inconsistent position.* An adjustment, with respect to an item or transaction, which would result in a net increase in the amount of the income taxes previously determined for prior taxable years is authorized only if (1) the taxpayer with respect to which the determination is made has, in connection with an item or transaction affecting the determination of its excess profits credit, maintained a position which is inconsistent with the erroneous treatment of such item or transaction for prior taxable years, and (2) such inconsistent position is adopted in the determination.

An adjustment, with respect to an item or transaction, which would result in a net decrease in the amount of the income taxes previously determined for prior taxable years is authorized only if (1) the Commissioner, in connection with an item or transaction affecting the determination of the taxpayer's excess profits credit, has maintained a position which is inconsistent with the erroneous treatment of such item or transaction for prior taxable years, and (2) such inconsistent position is adopted in the determination.

Neither the Commissioner nor the taxpayer is required to adopt an inconsistent position with respect to the treatment of an item or transaction in the determination of the excess profits credit because of the fact that such item or transaction was incorrectly treated in the determination of the income tax liability

of the taxpayer, or a predecessor, for a prior taxable year or years, under the law applicable to such year or years. Such item or transaction may, in the determination of the excess profits credit, be treated in a manner consistent with the incorrect treatment accorded in the determination of the income tax liability if neither the Commissioner nor the taxpayer objects. Either the Commissioner or the taxpayer, however, may insist upon the correct treatment of such item or transaction in the determination of the excess profits credit under the law applicable to the excess profits tax taxable year, but such action constitutes the maintenance of an inconsistent position and will result in an adjustment under section 734, if the party insisting upon such treatment is the party who would be adversely affected by such adjustment.

A taxpayer which has taken an inconsistent position with respect to an item or transaction affecting the determination of its excess profits credit may, upon notice to the Commissioner in writing, withdraw from such position.

Inconsistent treatment within the meaning of section 734 may relate to the principle or rule of law applied in determining the taxable status of an item or transaction, or it may relate only to the amount of the item or transaction which is to be taken into account for tax purposes. The inconsistency is to be ascertained by reference to the actual treatment of the item or transaction for prior taxable years rather than to what the taxpayer or the Commissioner may have urged.

If a determination of the excess profits tax liability for one taxable year adopts with respect to an item or transaction an inconsistent position which results in an adjustment under section 734, similar treatment of the same item or transaction for subsequent excess profits tax taxable years does not authorize a further adjustment under such section.

(d) *Law applicable in determination of error.* Whether there was an erroneous treatment of the item or transaction for prior taxable years is to be determined under the provisions of the internal revenue laws applicable with respect to such years. If the inconsistent treatment adopted in the determination of the excess profits tax liability is based upon an authoritative judicial interpretation of the applicable revenue law which differs from the interpretation of such law accepted in the determination of the tax liability for such prior years, then the treatment accorded the item or transaction for such prior years is erroneous within the meaning of section 734.

Section 734 does not authorize an adjustment if the difference between the treatment accorded an item or transaction in computing the excess profits credit and the treatment accorded such item or transaction in computing the tax liability for prior taxable years is occasioned solely by reason of an adjustment required by a specific provision of the Act, such as the adjustments required by section 711 (b) to normal-tax net income and special-class net income in computing excess profits net income. Since the disallowances under section 733 of deductions on account of expenditures for advertising or the promotion of good will are not required by the Act but are merely permissive at the election of the taxpayer, and since section 733 specifically provides that, if an election is made, the treatment of such expenditures as deductions for prior taxable years shall be considered incorrect, an adjustment under section 734 may be authorized in the case of such a disallowance.

The rule relative to the burden of proof to establish, in any Tax Court or court proceeding, that an inconsistent position has been taken, is prescribed in section 734 (b) (3). If the net effect of the adjustment by reason of the alleged inconsistency would be an increase in the income taxes previously determined for the prior taxable year or years, the burden of proof is upon the Commissioner. If the net effect of such adjustment would be a decrease in the income taxes previously determined for the prior taxable year or years, the burden of proof is upon the taxpayer. Inasmuch as the adjustment under section 734 is a factor in the determination of the excess profits tax liability, the provisions relative to the burden of proof in a Tax Court or court proceeding do not relieve the taxpayer from responsibility for a full disclosure of the facts necessary to the correct determination of the tax liability.

§ 35.734–3 *Method and effect of adjustment.* The adjustment authorized by section 734, although measured by reference to the income taxes previously determined for prior taxable years, does not operate as an adjustment to the income tax liability for such years, but the amount of such adjustment is added to or subtracted from, as the case may be, the excess profits tax otherwise computed for the taxable year with respect to which the inconsistent position is adopted.

No adjustment with respect to an item or transaction is authorized unless the inconsistent position adopted in the determination is maintained by the party who would be adversely affected by such adjustment. See § 35.734–2 (c). Accordingly, if a determination for one taxable year adopts inconsistent positions with respect to several items or transactions, it is necessary to make separate and distinct computations with respect to each such item or transaction in order to ascertain the amount of the potential adjustment with respect to each such item or transaction and whether an adjustment with respect to such item or transaction is authorized. If several adjustments are authorized with respect to one excess profits tax taxable year, the separate adjustments are aggregated and the aggregate net increase or net decrease is added to, or subtracted from, as the case may be, the excess profits tax otherwise computed for such taxable year. In ascertaining the amount of the adjustment with respect to a particular item or transaction, no effect shall be given to the computations made for the purpose of determining the amount of the adjustment with respect to any other item or transaction. If the several authorized adjustments result in an aggregate net increase, the excess profits tax liability for such taxable year shall not in any case be less than the amount of such aggregate net increase.

If the authorized adjustments with respect to one excess profits tax taxable year result in an aggregate net decrease and the amount of such decrease exceeds the excess profits tax (computed without regard to the provisions of section 734) for such year, the excess may be carried over and subtracted from the excess profits tax in each succeeding taxable year until such excess is exhausted. If excesses result from adjustments with respect to two or more excess profits tax taxable years, such excesses shall be carried over in the order of their occurrence.

Example.

	1942	1943	1944	1945	1946	1947
Tax (computed without regard to provisions of section 734)	$10,000	$20,000	$15,000	$7,000	$3,000	$8,000
Aggregate net decrease under section 734	(40,000)	----------	(20,000)	----------	----------	----------
Excess	(30,000)	----------	(5,000)	----------	----------	----------

(a) The $30,000 excess from 1942 will be subtracted from the tax of $20,000 for 1943; the remaining $10,000 will not be subtracted from any 1944 tax since such tax has been absorbed by the $20,000 net decrease for that year; such remaining $10,000 will, however, be subtracted from the $7,000 tax for 1945, and the $3,000 tax for 1946.

(b) The full $5,000 excess from 1944 will be subtracted from the tax of $8,000 for 1947, since the excess from 1942 has been exhausted in 1946 and the tax for 1946 has been reduced to zero.

The amount of the credit for foreign taxes allowable under the provisions of section 729 shall be determined before giving effect to any adjustment under this section.

§ 35.734–4 *Ascertainment of amount of adjustment.* To ascertain the amount of the adjustment, it is necessary to determine the amount of the increase or decrease in each income tax previously determined for each of the prior taxable years which would have resulted if the item or transaction erroneously treated had received the correct treatment under the law applicable with respect to such tax for such year. To each such increase or decrease there shall be added interest thereon computed as if the increase or decrease constituted a deficiency or an overpayment, as the case may be, with respect to such tax for such year. In all such cases interest shall be computed to the 15th day of the third month following the close of the excess profits tax taxable year with respect to which the determination of the excess profits tax liability is made.

If only one income tax for one prior taxable year is involved, the increase or decrease in such tax for such year plus the interest thereon is the amount of the

adjustment with respect to the particular item or transaction.

If two or more income taxes for one prior taxable year, or two or more prior taxable years are involved, it is necessary to determine the increase or decrease in each income tax previously determined for each such year, plus the interest on each such increase or decrease. The difference between the sum of the increases, including the interest thereon, and the sum of the decreases, including the interest thereon, shall be ascertained and the net increase or net decrease so determined is the amount of the adjustment with respect to the particular item or transaction.

The computation to determine the increase or decrease in each income tax for each year shall be made as follows:

(a) The amount of the tax previously determined must first be ascertained. This may be the amount of tax shown on the taxpayer's return, but if any changes in that amount have been made they must be taken into account, including any adjustment previously made under the provisions of section 820 of the Revenue Act of 1938 or section 3801 of the Internal Revenue Code. In such cases, the tax previously determined will be the tax shown on the return, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. If no amount was shown as the tax on the return, or if no return was made, the tax previously determined will be the sum of the amounts previously assessed (or collected without assessment) as deficiencies, decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

(b) After the tax previously determined has been ascertained, a recomputation must be made to ascertain the increase or decrease in tax represented by the difference, if any, between the tax previously determined and the tax as recomputed upon the basis of the correct treatment of the item or transaction.

With the exception of the items upon which the tax previously determined was based and the item or transaction with respect to which the erroneous treatment occurred, no item shall be considered in computing the amount of the increase or decrease in the tax previously determined. If the treatment of any item upon which the tax previously determined was based, or if the application of any provisions of the internal revenue laws with respect to such tax depends upon the amount of income (e. g., charitable contributions, foreign tax credit, earned income credit), readjustment of such items in conformity with the change in the amount of the income which results from the correct treatment of the item or transaction in respect of which the inconsistent position was adopted is necessary as part of the recomputation.

Example. In December, 1934, the X Corporation in pursuance of a plan of reorganization transferred all of its assets except cash to the Y Corporation in exchange for all of the stock of the Y Corporation, such stock having a fair market value of $300,000. The assets transferred, consisting of real estate and securities, had an adjusted basis in the hands of the X Corporation of $400,000. Among such assets was a building, which was acquired by the X Corporation in 1924, and which had an adjusted basis in the hands of the X Corporation of $100,000 and an estimated remaining life of 20 years. The building had a fair market value of $80,000 at the time of the transfer. Both corporations make their returns on the calendar year basis. The exchange was treated as taxable and the loss of $100,000 realized by the X Corporation was recognized. For each of the years 1935 to 1941, inclusive, the Y Corporation was allowed a deduction for depreciation in the amount of $4,000 computed on the cost basis of $80,000. In its excess profits tax return for the calendar year 1942, the Y Corporation claimed that the assets acquired from the X Corporation should have a basis of $400,000 for invested capital purposes, including a basis of $100,000 for the building, and claimed a deduction of $5,000 for depreciation on the building for such year. This position was based upon the contention that the 1934 exchange was a nontaxable reorganization, resulting from the acquisition by Y Corporation in exchange solely for its voting stock of substantially all of the properties of X Corporation; and that the basis in the hands of the Y Corporation of the assets acquired upon the exchange was the same as the adjusted basis in the hands of the transferor. Timely claims for refund based upon the allowance of additional deductions for depreciation for the taxable years 1939, 1940, and 1941 were filed. The statute of limitations prevents any refund of overpayments or assessment of deficiencies for the taxable years 1934 to 1938, inclusive. The Commissioner's determination of the excess profits tax liability for the calendar year 1942 adopts the inconsistent position asserted by the Y Corporation and, accordingly, if the computation under section 734 (d) discloses a net increase in the taxes previously determined for the taxable years for which correction is prevented, an adjustment is authorized under the provisions of section 734.

The X Corporation was not subject to the income tax imposed by Title IA of the Revenue Act of 1934. Its tax previously determined for the taxable year 1934 is $4,125, computed upon an income of $30,000. The corporation omitted from its gross income an item of rental income amounting to $3,000 and neglected to take a deduction for interest amount to $1,500. During the taxable year it realized a gain of $10,000 from the sale of a capital asset.

The increase in the tax of the X Corporation previously determined for 1934, plus the interest thereon, is computed as follows:

Tax previously determined for 1934	$4,125
Net income for 1934 upon which tax previously determined was based	30,000
Plus: Capital loss previously allowed (limited to capital gain plus $2,000)	12,000
Net income	42,000
Tax as recomputed	5,775
Tax previously determined	4,125
Increase in tax previously determined	1,650
Interest on increase in tax	792
Total increase for 1934	2,442

In accordance with the provisions of section 734 (d), the recomputation does not take into consideration the item of $3,000, representing rental income which was omitted from gross income, or the item of $1,500, representing interest paid, for which no deduction was allowed.

The Y Corporation was not subject to the income tax imposed by Title IA of the Revenue Acts of 1934, 1936, or 1938. The decrease in the tax of the Y Corporation previously determined for each of the taxable years 1935, 1936, 1937, and 1938, which results solely from the allowance of an additional deduction of $1,000 for depreciation in each of such years, plus the interest on each such decrease, is assumed to be as follows:

Year	Tax	Interest	Total
1935	$137.50	$57.75	$195.25
1936	220.00	79.20	299.20
1937	220.00	66.00	286.00
1938	190.00	45.60	235.60

The amount of the adjustment to be added to the excess profits tax of the Y Corporation otherwise determined for the taxable year 1942 is as follows:

Increase for 1934		$2,442.00
Less:		
Decrease for 1935	$195.25	
Decrease for 1936	299.20	
Decrease for 1937	286.00	
Decrease for 1938	235.60	
		1,016.05
Net increase (amount of adjustment authorized)		1,425.95

§ 35.734–5 *Interest.* The portion of an adjustment under section 734 which represents interest is characterized as interest for certain tax purposes and is includible in gross income, or allowable as a deduction in computing net income, as the case may be, for the taxable year in which falls the date prescribed for the payment of the excess profits tax for the taxable year to which the adjustment or, in the case of an adjustment involving a carry-over, the portion of such adjustment is applied, regardless of the method of accounting employed by the taxpayer. The date prescribed for payment of the tax is, in the case of a domestic corporation, the 15th day of the third month following the close of the taxable year and, in the case of a foreign corporation not having an office or place of business in the United States, the 15th day of the sixth month following the close of the taxable year.

Under the rule prescribed, if the adjustments in respect of an excess profits tax taxable year result in a net increase, or an aggregate net increase, the portion of such increase which represents interest shall be allowed as a deduction in computing net income for the succeeding taxable year. Thus, under the facts set forth in the example contained in § 35.734–4, the portion of the net increase which represents interest is $543.45 (interest on increases, $792, minus interest on decreases, $248.55), and such interest is allowable as a deduction in computing net income for the calendar year 1943.

If the adjustments in respect of an excess profits tax taxable year result in a net decrease, or an aggregate net decrease, the interest contained in that portion of such decrease which is subtracted from the tax for any taxable year shall be included in the gross income for the succeeding taxable year. For such purpose, no portion of the amount sub-

tracted in any taxable year shall be deemed to represent interest until the portion of the net decrease which represents tax has been exhausted.

Example. For the calendar year 1942, Corporation X had an excess profits tax liability of $9,000 (computed without regard to section 734) and an authorized adjustment under section 734 resulting in a net decrease of $12,000, of which $8,000 represents tax and $4,000 represents interest. In giving effect to the adjustment, $9,000 will be subtracted from the tax for 1942 and the balance will be carried over to succeeding taxable years. Since $8,000 of the net decrease represents tax, only $1,000 of the amount subtracted in 1942 represents interest and hence $1,000 will be included as interest in the taxpayer's gross income for 1943. The entire amount of the $3,000 to be carried over and subtracted from the tax for a succeeding taxable year represents interest, since the portion of the net decrease which represents tax is exhausted in 1942.

SEC. 735. NONTAXABLE INCOME FROM CERTAIN MINING AND TIMBER OPERATIONS. [Added by sec. 209 (c), Rev. Act 1942.]

(a) *Definitions.* For the purposes of this section, section 711 (a) (1) (I), and section 711 (a) (2) (K)—

(1) *Producer.* The term "producer" means a corporation which extracts minerals from a mineral property, or cuts logs from a timber block, in which an economic interest is owned by such corporation.

(2) *Mineral unit.* The term "mineral unit" means a unit of metal, coal, or nonmetallic substance in the minerals recovered from the operation of a mineral property.

(3) *Timber unit.* The term "timber unit" means a unit of timber recovered from the operation of a timber block.

(4) *Excess output.* The term "excess output" means the excess of the mineral units or the timber units for the taxable year over the normal output.

(5) *Normal output.* The term "normal output" means the average annual mineral units, or the average annual timber units, as the case may be, recovered in the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939 (hereinafter called "base period"), of the person owning the mineral property or the timber block (whether or not the taxpayer). The average annual mineral units or timber units shall be computed by dividing the aggregate of such mineral units or timber units for the base period by the number of months for which the mineral property or the timber block was in operation during the base period and by multiplying the amount so ascertained by twelve. In any case in which the taxpayer establishes, under regulations prescribed by the Commissioner with the approval of the Secretary, that the operation of any mineral property or any timber block is normally prevented for a specified period of each year by physical events outside the control of the taxpayer, the number of months during which such mineral property or timber block is regularly in operation during a taxable year shall be used in computing the average annual mineral units, or timber units, instead of twelve. Any mineral property, or any timber block, which was in operation for less than six months during the base period shall, for the purposes of this section, be deemed not to have been in operation during the base period.

(6) *Mineral property.* The term "mineral property" means a mineral deposit, the development and plant necessary for the extraction of the deposit, and so much of the surface of the land as is necessary for purposes of such extraction.

(7) *Minerals.* The term "minerals" means ores of the metals, coal, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(8) *Timber block.* The term "timber block" means an operation unit existing as of December 31, 1941, which includes all the taxpayer's timber which would logically go to a single given point of manufacture, but shall not include any operation unit acquired after December 31, 1941.

(9) *Normal unit profit.* The term "normal unit profit" means the average profit for the base period per mineral unit for such period, determined by dividing the net income with respect to minerals recovered from the mineral property (computed with the allowance for depletion computed in accordance with the basis for depletion applicable to the current taxable year) during the base period by the number of mineral units recovered from the mineral property during the base period.

(10) *Estimated recoverable units.* The term "estimated recoverable units" means the estimated number of units of metal, coal, or nonmetallic substances in the estimated recoverable minerals from the mineral property at the end of the taxable year plus the excess output for such year. All estimates shall be subject to the approval of the Commissioner, the determinations of whom, for the purposes of this section, shall be final and conclusive.

(11) *Exempt excess output.* The term "exempt excess output" for any taxable year means a number of units equal to the following percentages of the excess output for such year:

100 per centum if the excess output exceeds 50 per centum of the estimated recoverable units;

95 per centum if the excess output exceeds 33⅓ but not 50 per centum of the estimated recoverable units;

90 per centum if the excess output exceeds 25 but not 33⅓ per centum of the estimated recoverable units;

85 per centum if the excess output exceeds 20 but not 25 per centum of the estimated recoverable units;

80 per centum if the excess output exceeds 16⅔ but not 20 per centum of the estimated recoverable units;

60 per centum if the excess output exceeds 14⅔ but not 16⅔ per centum of the estimated recoverable units;

40 per centum if the excess output exceeds 12½ but not 14⅔ per centum of the estimated recoverable units;

30 per centum if the excess output exceeds 10 but not 12½ per centum of the estimated recoverable units;

20 per centum if the excess output exceeds 5 but not 10 per centum of the estimated recoverable units.

(12) *Unit net income.* The term "unit net income" means the amount ascertained by dividing the net income (computed with the allowance for depletion) from the coal or iron ore or the timber recovered from the coal mining property, iron mining property, or timber block, as the case may be, during the taxable year by the number of units of coal or iron ore, or timber recovered from such property in such year.

(b) *Nontaxable income from exempt excess output*—(1) *General rule.* For any taxable year for which the excess output of mineral property which was in operation during the base period exceeds 5 per centum of the estimated recoverable units from such property, the nontaxable income from exempt excess output for such year shall be an amount equal to the exempt excess output for such year multiplied by the normal unit profit, but such amount shall not exceed the net income (computed with the allowance for depletion) attributable to the excess output for such year.

(2) *Coal and iron mines.* For any taxable year, the nontaxable income from exempt excess output of a coal mining or iron mining property which was in operation during the base period shall be an amount equal to the excess output of such property for such year multiplied by one-half of the unit net income from such property for such year, or an amount determined under paragraph (1), whichever the taxpayer elects in accordance with regulations prescribed by the commissioner with the approval of the Secretary.

(3) *Timber properties.* For any taxable year, the nontaxable income from exempt excess output of a timber block which was in operation during the base period shall be an amount equal to the excess output of such property for such year multiplied by one-half of the unit net income from such property for such year.

(c) *Nontaxable bonus income.* The term "nontaxable bonus income" means the amount of the income derived from bonus payments made by any agency of the United States Government on account of the production in excess of a specified quota of a mineral product or of timber the exhaustion of which gives rise to an allowance for depletion under section 23 (m), but such amount shall not exceed the net income (computed with the allowance for depletion) attributable to the output in excess of such quota.

(d) *Rule in case income from excess output includes bonus payment.* In any case in which the income attributable to the excess output includes bonus payments (as provided in subsection (c)), the taxpayer may elect, under regulations prescribed by the Commissioner with the approval of the Secretary, to receive either the benefits of subsection (b) or subsection (c) with respect to such income as is attributable to excess output above the specified quota.

§ 35.735–1 *General rule.* Section 735 provides specific rules for the computation of nontaxable income from exempt excess output and of nontaxable bonus income which are excluded in the computation of excess profits net income of a producer of minerals, or a producer of logs or lumber from a timber block, as defined in such section.

§ 35.735–2 *Definitions.* For the purposes of section 735, section 711 (a) (1) (I), and section 711 (a) (2) (K):

(a) *Producer.* The term "producer" means a corporation which extracts minerals from a mineral property, or cuts logs from a timber block, in which an economic interest is owned by such corporation. Although section 711 (a) (1) (I) and section 711 (a) (2) (K) exclude certain nontaxable income in the computation of excess profits net income in the case of a producer of logs or lumber, a producer of lumber is not within the provisions of this subsection unless such corporation is also a producer of the logs from which such lumber is sawed. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in minerals in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which it must look for a return of its capital. A taxpayer which has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual

relation to the owner, it possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey an economic interest. The mere ownership of the development and plant necessary to the extraction of the minerals in place or the felling and logging of the timber is not an economic interest for the purposes of section 735. Thus, a corporation which owns the equipment necessary to the extraction of minerals or the logging of timber and which acts as an independent contractor or as an agent in extracting minerals or timber, receiving as consideration a portion of the net income from the property, but which does not own an economic interest in the mineral property or timber block is not a producer within the provisions of this paragraph. However, the owner of the economic interest in the mineral property or timber block and from which the mineral or timber is being extracted by the independent contractor or the agent is the producer within the provisions of this paragraph.

(b) *Mineral unit.* The term "mineral unit" means a unit of metal, coal, or nonmetallic substance in the minerals recovered from the operation of a mineral property. A mineral unit does not mean the number of units of minerals as defined in paragraph (g) of this section but refers to the units of metal, coal, or nonmetallic substances contained in such minerals. If a corporation extracts from the same mineral property two or more minerals containing different metals, coal, or nonmetallic substances, or if two or more metals, coal, or nonmetallic substances are contained in the same mineral extracted by a corporation from a mineral property, a determination of mineral units must be made with respect to each type of metal, coal, or nonmetallic substance contained in such minerals. A unit is any designation of quantity, such as ton, pound, quart, ounce, kilogram, gram, etc., customarily used by the taxpayer as a standard of measurement.

(c) *Timber unit.* The term "timber unit" means a unit of timber recovered from the operation of a timber block. It does not mean the units of lumber, boards, or other wood products sawed from the timber, but refers to the actual logs felled prior to processing at the sawmill. The fact that more than one species of timber is cut by a taxpayer from a timber block shall not be taken into account and a timber unit shall not be established with respect to each species of timber. A unit is any designation of quantity such as board feet measure, log scale, cords, or other units customarily used by the taxpayer as a standard of measurement.

(d) *Excess output.* The term "excess output" means the excess of the mineral units or the timber units for the taxable year over the normal output. If the taxpayer operated two or more mineral properties or two or more timber blocks, the excess output shall be determined with respect to each such mineral property and each such timber block and shall not be computed upon the basis of the aggregate of the mineral properties or timber blocks owned by the taxpayer. If two or more metals, coal, or nonmetallic substances are contained in the minerals extracted from a mineral property, the determination of the excess output of mineral products extracted from such mineral property for an excess profits tax taxable year shall be made with respect to each separate type of metal, coal, or nonmetallic substance, i. e., the amount by which the mineral units of each type for the taxable year exceeds the normal output of such type. The excess output of a mineral property from which minerals are extracted containing two or more types of metals, coal, or nonmetallic substances shall not be made upon an aggregate basis, i. e., the amount by which the aggregate of all types of mineral units for the taxable year exceeds the aggregate of the normal output of all such types.

The mineral units for an excess profits tax taxable year shall be the number of units of metal, coal, or nonmetallic substances in the minerals recovered from a mineral property during the taxable year, which would be used in computing the allowance for depletion for the purposes of Chapter 1 if the depletion of the mineral property were computed without regard to discovery value or percentage depletion. See § 29.23 (m)–2 of this chapter.

The timber units for an excess profits tax taxable year shall be the number of units of timber felled during the year, which is used in the computation of the depletion allowance for the purposes of Chapter 1. See § 29.23(m)–21 of this chapter. However, no timber felled or logs cut from standing timber acquired after December 31, 1941, shall be considered in determining the number of timber units for the taxable year.

(e) *Normal output.* The term "normal output" means the average annual mineral units, or the average annual timber units, as the case may be, recovered in the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939 (referred to in §§ 35.735–1 through 35.735–5 as the base period) of the person owning the mineral property or the timber block, whether or not such person is the taxpayer claiming relief under section 711 (a) (1) (I) or section 711(a) (2) (K), and section 735. A person includes an individual, a trust, estate, partnership, company, or corporation. See section 3797. If the mineral property or timber block was not owned by the taxpayer for the entire base period, the taxpayer must, in its first excess profits tax return in which the benefits of section 711(a) (1) (I) or section 711 (a) (2) (K), and section 735 are claimed, state the name and address of each person owning the mineral property or timber block during the base period and submit evidence establishing the mineral units or the timber units recovered from the mineral property or timber block by such other person during the period of its ownership, and the number of months in such period.

In any case in which two or more metals, coal, or nonmetallic substances are contained in the minerals recovered from a mineral property, a normal output shall be computed with respect to each type of metal, coal, or nonmetallic substance in such minerals.

The average annual mineral units or timber units shall be computed by dividing the aggregate of the mineral units of each type of metal, coal, or nonmetallic substance or the aggregate of the timber units for the base period by the number of months for which the mineral property or timber block was in operation during the base period and by multiplying the amount so ascertained by twelve. In any case in which the taxpayer establishes that the operation of a mineral property or a timber block is normally prevented for a specified period each year by physical events outside the control of the taxpayer, the number of months during which such mineral property or timber block is regularly in operation during a taxable year shall be used in computing the average annual mineral units, or timber units, instead of twelve. If any excess profits tax taxable year for which excess output is computed for the purposes of section 735 is a taxable year of less than twelve months, the number of months in such year, in lieu of twelve and in lieu of the number of months specified in the preceding sentence (if less than such number of months), shall be used in computing the average annual mineral units or timber units.

The mineral units for a taxable year in the base period shall be the number of units of each type of metal, coal, or nonmetallic substance in the minerals recovered from a mineral property during the taxable year, which would be used in computing the depletion allowance for the purposes of Chapter 1 if the depletion of the mineral property were computed without regard to discovery value or percentage depletion. See § 29.23 (m)–2 of this chapter. The timber units for a taxable year shall be the number of units of timber felled during the year used in the computation of the depletion allowance for the purposes of Chapter 1. See § 29.23 (m)–21 of this chapter.

Any mineral property, or any timber block, which was in operation for less than six months during the base period shall, for the purposes of section 735, be deemed not to have been in operation during the base period. Such months need not be consecutive months.

(f) *Mineral property.* The term "mineral property" means a mineral deposit, the development and plant necessary for the extraction of the deposit, and so much of the surface of the land as is necessary for the purposes of such extraction. The term "mineral deposit" refers to the minerals in place. The taxpayer's interest in each separate mineral property is a separate "property." If the mineral deposit in which a taxpayer owns an economic interest extends beyond the boundaries of a single tract or parcel of land a separate mineral property exists with respect to each tract or parcel of land into which the mineral

deposit extends. Where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

(g) *Minerals.* The term "minerals" means ores of the metals, coal, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(h) *Timber block.* The term "timber block" means an operation unit existing as of December 31, 1941, which includes all the taxpayer's timber which would logically go to a single given point of manufacture, but shall not include any operation unit acquired after December 31, 1941. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development.

(i) *Normal unit profit.* The term "normal unit profit" means the average profit for the base period per mineral unit for such period, determined by dividing the net income with respect to minerals recovered from the mineral property (computed with the allowance for depletion determined in accordance with the basis for depletion, cost basis depletion, discovery value depletion, or percentage depletion, applicable to the current taxable year) during the base period by the total number of mineral units recovered from the mineral property during the base period.

If two or more metals, coal, or nonmetallic substances are contained in the minerals extracted from a mineral property, a normal unit profit shall be established for each class of mineral unit. The normal unit profit for each class of mineral unit shall be determined by dividing the net income with respect to such type of metal, coal, or nonmetallic substance in the minerals recovered from the mineral property during the base period by the total number of mineral units of such class for the base period.

(1) *Net income.* Net income with respect to minerals recovered from the mineral property (computed with the allowance for depletion) means the "gross income from the property" as defined in subparagraph (2) of this paragraph less the allowable deductions attributable to the mineral property with respect to which exempt excess output is computed and the allowable deductions attributable to the processes listed in subparagraph (2) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, and including the allowance for depletion. The allowance for depletion shall be computed in accordance with the provisions of section 23(m) and section 114(b) and the regulations thereunder. The allowance for depletion for each year during the base period shall, for the purposes of section 735, be computed upon the same basis used in computing the allowance for depletion during the excess profits tax taxable year beginning after December 31, 1941, for which the benefits of section 735 are claimed. Thus, if during the base period the taxpayer computed the allowance for depletion with respect to a mineral property upon the cost basis, and if during each excess profits tax taxable year, for which the benefits of section 735 are claimed, the taxpayer computes the allowance for depletion based upon a percentage of income, the allowance for depletion for each year in the base period shall be recomputed as a percentage of income under the law applicable to each such year. In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in subparagraph (2), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (i) the mineral extraction and the processes listed in subparagraph (2) and (ii) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in subparagraph (2) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in subparagraph (2) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

If two or more metals, coal, or nonmetallic substances are contained in the minerals extracted from a mineral property, a net income with respect to each type of metals, coal, or nonmetallic substance shall be established. Such net income shall be the gross income with respect to such type minus the allowable deductions for such year attributable to such type. The allowable deductions for any taxable year attributable to each type of metal, coal, or nonmetallic substance shall be computed as follows: There shall be determined an amount which bears the same ratio to the total allowable deductions (not including the allowance for depletion) attributable to the mineral property from which the minerals containing such type of metal, coal, or nonmetallic substance has been recovered, as the gross income from such type of metal, coal, or nonmetallic substance bears to the total gross income from such property. To this amount shall be added the allowance for depletion computed with respect to such type of metal, coal, or nonmetallic substance.

(2) *Gross income from the property.* For the purposes of section 735 the term "gross income from the property" for any year in the base period means the amount for which the taxpayer sold the crude mineral product (the product in the form in which it emerges from the mine) of the mineral property in the immediate vicinity of the mine, but, if the product was transported or processed (other than by processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before such transportation or processing. If there was no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude state was merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below. The processes excepted are as follows:

(i) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(ii) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(iii) In the case of iron ore, ball and sagger clay or rock asphalt, and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(iv) In the case of lead, zinc, copper, gold, silver, or fluorspar ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In case any of the excepted processes were not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by taxpayer, the proportionate profits attributable to transportation should be subtracted from the sale price of the product to determine "gross income from the property."

There shall be excluded in determining the "gross income from the property," for each year in the base period, an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and were not otherwise excluded from the "gross income from the property." If royalties in the form of bonus payments were paid in respect of the property in a taxable year in the base period or any prior years, or if advanced royalties were paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from "gross income from the property" for a taxable year in the base period on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the taxable year.

If the taxpayer paid rents, royalties, or bonuses with respect to the mineral property during the base period, and in an excess profits tax taxable year for which the benefits of section 735 are claimed owns an economic interest in such property which does not require the payments of rents, royalties, or bonus payments, the amount of such rents, royalties, and bonuses paid during the base period shall, for the purposes of section 735, not be deducted in the computation of the gross income from the property. If the taxpayer paid rents, royalties, or bonuses with respect to the mineral property during the base period and in an excess profits tax taxable year for which the benefits of section 735 are claimed pays rents, royalties, or bonuses in amounts different from those paid during the base period because of a change in its economic interest, the gross income from the property during the base period shall be recomputed as if the new contractual terms pursuant to which the new rents, royalties, or bonuses are paid had been in effect during the base period. If the economic interest of the taxpayer during the base period was such that it did not pay rents, royalties, or bonuses, but such interest has changed so that during the excess profits tax taxable year for which the benefits of section 735 are claimed the taxpayer pays rents, royalties, or bonuses, the gross income from the property during the base period shall be recomputed as if the contractual agreement pursuant to which rents, royalties, or bonuses are paid during the excess profits tax taxable year were in full force and effect during the base period. If the economic interest of a person other than the taxpayer in the mineral property during any year in the base period was different from the economic interest of the taxpayer in the excess profits tax taxable year for which the benefits of section 735 are claimed, the gross income of such person from the property during such base period year shall be recomputed as if its economic interest in the mineral property were the same as the economic interest of the taxpayer in the excess profits tax taxable year for which the benefits of section 735 are claimed.

If two or more metals, coal, or nonmetallic substances are contained in the minerals extracted from a mineral property, the gross income from such property shall be allocated to each type of metal, coal, or nonmetallic substance for which a separate mineral unit is established. If the gross income from the property is determined by excluding the costs and proportionate profits attributable to transportation and to the processes not listed above, or if such gross income is an amount different from the gross proceeds received from the sale of the minerals, the gross income attributable to each type of metal, coal, or nonmetallic substance shall be an amount which bears the same ratio to the gross income from the property which the gross proceeds received from the sale of such type of metal, coal, or nonmetallic substance in the minerals bears to the total gross proceeds received from the sales of all such types.

(j) *Estimated recoverable units.* The term "estimated recoverable units" means the estimated number of units of metal, coal, or nonmetallic substances in the estimated recoverable minerals from the mineral property at the end of the excess profits tax taxable year for which the benefits of section 735 are claimed plus the excess output for such year. If the number of recoverable units of metal, coal, and nonmetallic substances in the minerals in the property have been previously estimated for the prior year or years, and if there has been no known change in the facts upon which the prior estimate was based, the number of recoverable units of metal, coal, and nonmetallic substances in the minerals in the property as of the taxable year will be the number remaining from the prior estimate. Thus, the recoverable units estimated to remain at the end of a taxable year shall be computed, generally, as the estimated recoverable units as of the beginning of the taxable year minus the output for the year. In any case in which it is ascertained either by the taxpayer or the Commissioner as the result of operations or development work prior to the close of the taxable year that the remaining recoverable mineral units are materially greater or less than the number remaining from the prior estimate, the estimate of the remaining recoverable units shall be revised and the revised estimate will be used for the purposes of computing exempt excess output under the provisions of section 735 (a) (11) and § 35.735–2 (k) unless a change in the facts requires another revision. Regardless of the method of determining the estimated number of units of metal, coal, or nonmetallic substances in the estimated recoverable minerals from the mineral property at the end of the excess profits tax taxable year, the estimated recoverable units for the purposes of section 735 shall be the number of such units plus the excess output for such year. The estimated number of units of metal, coal, or nonmetallic substance in the estimated recoverable mineral means the metal, coal, or nonmetallic substance content of the minerals and not the estimated recoverable units of the minerals which are the ores of the metals, coal, or nonmetallic substances. The estimated recoverable units from any mineral property shall be determined with respect to each type of metal, coal, or nonmetallic substance in the estimated recoverable minerals and shall not be determined as the aggregate of all classes of mineral units attributable to all such types of metal, coal, or nonmetallic substances. As to the determination of the estimated recoverable units of mineral products, see § 29.23 (m)–9 of this chapter.

All estimates of recoverable units of metal, coal, and nonmetallic substances in the estimated recoverable minerals from the mineral property shall be subject to the approval of the Commissioner, and the determination of the Commissioner for the purposes of section 735 shall be final and conclusive.

(k) *Exempt excess output.* The term "exempt excess output" for any taxable year means a number of units equal to the following percentages of the excess output for such year:

100 percent if the excess output exceeds 50 percent of the estimated recoverable units;

95 percent if the excess output exceeds 33⅓ but not 50 percent of the estimated recoverable units;

90 percent if the excess output exceeds 25 but not 33⅓ percent of the estimated recoverable units;

85 percent if the excess output exceeds 20 but not 25 percent of the estimated recoverable units;

80 percent if the excess output exceeds 16⅔ but not 20 percent of the estimated recoverable units;

60 percent if the excess output exceeds 14⅔ but not 16⅔ percent of the estimated recoverable units;

40 percent if the excess output exceeds 12½ but not 14⅔ percent of the estimated recoverable units;

30 percent if the excess output exceeds 10 but not 12½ percent of the estimated recoverable units;

20 percent if the excess output exceeds 5 but not 10 percent of the estimated recoverable units.

Since the excess output and the estimated recoverable units, in the case of a mineral property from which are extracted minerals containing two or more types of metal, coal, or nonmetallic substances, shall be determined with respect to the mineral units comprising the excess output and the mineral units contained in the estimated recoverable units for each separate type of metal, coal, or nonmetallic substance, the percentage which the excess output is of the estimated recoverable units shall be based upon the excess output and the estimated recoverable units of each separate type and shall not be computed with respect to the aggregate of all classes of mineral units. The percentage so determined with respect to each separate type of metal, coal, or nonmetallic substance shall then be multiplied by the excess output of such type of metal, coal, or nonmetallic substance in the minerals recovered from the mineral property, and the product of the two shall be considered the exempt excess output of that type of metal, coal, or nonmetallic substance.

(l) *Unit net income.* The term "unit net income" means the amount of net income per mineral unit of coal or iron or per timber unit for any excess profits tax taxable year for which the benefits of section 735 are claimed. It is ascertained by dividing the net income (computed with the allowance for depletion used in computing net income for the purposes of Chapter 1 for such year) from the coal or iron ore, or the timber, recovered during the taxable year from the coal mining property, the iron mining property, or the timber block, as the case may be, by the number of mineral units contained in the coal or iron ore recovered from such coal or iron mining property or by the number of timber units recovered from such timber block, in such year.

For the purposes of section 735(a)(12) and section 735(b)(2), the term "coal mining property" means the aggregate of all tracts or parcels of land containing coal deposits in which economic interests were owned, and from which coal was

extracted, by the taxpayer at any time after the beginning of the base period (excluding, however, any tract or parcel of land in which an economic interest was acquired, and from which coal was extracted, by any other person subsequent to the last date of ownership and operation by the taxpayer) to the extent that the coal extracted therefrom by the taxpayer was processed at a single preparation plant, regardless of whether the economic interest in one such tract or parcel of land differed from that in another.

For the purpose of section 735(a)(12) and section 735(b)(2), the term "iron mining property" means the aggregate of all tracts or parcels of land containing iron ore deposits in which economic interests were owned, and from which iron ore was extracted, by the taxpayer at any time after the beginning of the base period (excluding, however, any tract or parcel of land in which an economic interest was acquired, and from which iron ore was extracted, by any other person subsequent to the last date of ownership and operation by the taxpayer) to the extent that such tracts or parcels of land were operated by the taxpayer as an operation unit, regardless of whether the economic interest in one tract or parcel of land differed from that in another.

The net income (computed with the allowance for depletion) from the coal or the iron ore recovered from the coal mining property or the iron mining property during an excess profits tax taxable year for which the benefits of section 735 (b) (2) are claimed shall be the net income from the coal mining property or iron mining property from which such coal or iron ore is recovered, computed in a manner similar to that described in § 35.735–2 (i) with respect to a mineral property as if such coal mining property or iron mining property were a mineral property, except that the amount of depletion allowed in the computation of such net income shall be computed according to sections 23 (m) and 114, and the regulations thereunder.

The determination of net income from a timber block for an excess profits tax taxable year must be made with respect to each timber block separately and cannot be made with respect to the aggregate of the timber blocks owned by the taxpayer. Net income from a timber block includes only income which is attributable to that portion of the operation unit which was in existence on December 31, 1941; net income attributable to any standing timber acquired after December 31, 1941, and which after such date has become a part of the timber block existing on December 31, 1941, must be excluded. Net income from timber recovered from a timber block (computed with the allowance for depletion) means the net income attributable to timber and logging operations, not including transportation of the logs to the log or other market. That portion of the taxpayer's net income attributable to transportation or to manufacturing or remanufacturing, if the taxpayer which is a producer of logs from a timber block carries its operations beyond the logging stage, must be eliminated. If the taxpayer is engaged in activities in addition to timber and logging operations, the net income attributable to timber recovered from a timber block shall be computed as follows:

(1) *Net income.* Net income from timber recovered from a timber block (computed with the allowance for depletion) means the gross income from the timber block as defined in (2) of this paragraph, less the allowable deductions attributable to the timber block with respect to which exempt excess output is computed and the allowable deductions attributable to timbering and logging operations, but not including transportation of the logs to the log or other market, insofar as they relate to logs cut by the taxpayer from the timber block, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, and including the allowance for depletion. The allowance for depletion shall be that used in computing net income for the purposes of Chapter 1 for the taxable year. In cases where the taxpayer engages in activities in addition to timbering and logging operations, including in such additional activities transportation of the logs to the log or other market, deductions for depreciation, taxes, general expenses, and overhead which cannot be directly attributed to any specific activity shall be fairly apportioned between (i) the timber and logging operations, and (ii) the additional activities, taking into account the ratio which the operating expenses directly attributable to the timber and logging operations bear to the operating expenses directly attributable to the additional activities. If more than one timber block is involved, the deductions apportioned to the timber and logging operations shall, in turn, be fairly apportioned to the several timber blocks, taking into account their relative production.

(2) *Gross income from the timber block.* Gross income from the timber block means the amount for which the taxpayer sold the timber or the logs in the immediate vicinity of the timber block, but if the logs were transported or processed or manufactured or remanufactured before sale, it means the representative market or field price (as of the date of sale) of logs of like kind and grade before such transportation, processing, manufacture, or remanufacture. If there was no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any processing, manufacture, or remanufacture (or, if the logs were merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes, manufacture, and remanufacture.

In all cases there shall be excluded in determining the gross income from the timber block an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the timber block and are not otherwise excluded from the gross income from the timber block. If royalties in the form of bonus payments have been paid in respect of the timber block in the taxable year or any prior years or if advanced royalties have been paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from gross income from the timber block for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the taxable year. If advanced royalties have been paid in respect of the timber block in any taxable year ending on or after December 31, 1939, the amount excluded from gross income from the timber block for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to the rules provided in § 29.23(m)–10(e) of this chapter with respect to advanced royalties paid in the case of mineral properties.

§ 35.735–3 *Nontaxable income from exempt excess output.* Nontaxable income from exempt excess output is excluded in the computation of excess profits net income under section 711 (a) (1) (I) if the taxpayer uses the excess profits credit based on income or under section 711 (a) (2) (K) if the taxpayer uses the excess profits credit based on invested capital, and is determined as follows:

(a) *General rule.* If the excess output of a mineral property which was in operation during the base period exceeds 5 percent of the estimated recoverable units from such mineral property, computed as provided in § 35.735–2 (j) the nontaxable income from exempt excess output shall be an amount equal to the exempt excess output for such year (computed under § 35.735–2 (k)) multiplied by the normal unit profit (computed under § 35.735–2 (i)). In no event shall the amount of nontaxable income from exempt excess output exceed the net income (computed with the allowance for depletion) attributable to the excess output for such year. The net income attributable to excess output shall be that percentage of the net income from the mineral property which the excess output for the taxable year is of the total output for the taxable year. The net income from the mineral property shall be computed in accordance with the rules provided in § 35.735–2 (i) for the computation of net income from the mineral property for a taxable year in the base period.

If mineral units are determined for two or more types of metals, coal, or nonmetallic substances, the nontaxable income shall be determined with respect to the exempt excess output of each type of metal, coal, or nonmetallic substance. In no event shall nontaxable income from exempt excess output be determined with respect to any such type unless the mineral property was in operation during the base period and unless the excess output of such type exceeds 5 percent of the estimated recoverable units of such type of metal, coal, or non-

metallic substance in the mineral property.

If the minerals recovered from a mineral property contain two or more types of metals, coal, or nonmetallic substances, nontaxable income from exempt excess output of such property for a taxable year shall be the aggregate of the nontaxable incomes from exempt excess output of each type of metal, coal, or nonmetallic substance. The nontaxable income from exempt excess output of each type of metal, coal, or nonmetallic substance shall be an amount equal to the exempt excess output of such type of metal, coal, or nonmetallic substance (see § 35.735–2 (k)) multiplied by the normal unit profit for such type (see § 35.735–2 (i)). The nontaxable income from exempt excess output attributable to each type of metal, coal, or nonmetallic substance shall not exceed the net income (computed with the allowance for depletion) attributable to the excess output of such type for the taxable year. The net income attributable to the excess output of each type of mineral unit shall be determined as follows: The net income attributable to the mineral property for the taxable year shall be fairly allocated to each type of metal, coal, or nonmetallic substance contained in the minerals recovered from the mineral property in such year in accordance with the principles set forth in § 35.735–2 (i). The amount so allocated shall be divided by the total number of mineral units of such type of metal, coal, or nonmetallic substance for the taxable year, and the amount so determined shall be multiplied by the excess output of the mineral units of such type, determined in accordance with § 35.735–2 (d), for the year.

The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume that the taxpayer, which is on the calendar year basis, owns a mineral property from which is extracted a mineral containing one nonmetallic substance. The total output of such property during the four calendar years in the base period, the first of which began in 1936, was 416,000 tons and the aggregate of the net incomes for such years (including the allowance for depletion computed upon the same basis as for the year 1942) was $1,248,000. The normal output is 104,000 tons and the normal unit profit is $3 per ton. During 1942 minerals containing 200,000 tons of the nonmetallic substance were extracted from the property at a unit profit of $3.50 per ton. The net income for such year was $700,000. As of December 31, 1942, it is estimated that 1,000,000 tons of the nonmetallic substance remained in the mineral property. The amount of nontaxable income from exempt excess output to be excluded in the computation of excess profits net income for 1942 is $57,600, computed as follows:

1. Normal output (tons)	104,000
2. Output for 1942 (tons)	200,000
3. Excess output for 1942 (tons)	96,000
4. Estimated recoverable units for 1942 (1,000,000 tons plus item 3)	1,096,000
5. Percentage which item 3 is of item 4 (percent)	8.8
6. Percentage of item 3 to be used in computing exempt excess output (percent)	20
7. Exempt excess output for 1942 (tons) (item 3 times item 6)	19,200
8. Normal unit profit (per ton)	$3.00
9. Nontaxable income from exempt excess output (item 8 times item 7, but not in excess of item 12)	$57,600.00
10. Net income for 1942	$700,000.00
11. Unit net income for 1942 (per ton) (item 10 divided by item 2)	$3.50
12. Net income attributable to excess output for 1942 (item 3 times item 11)	$336,000.00

Example (2). Corporation A, which is on the calendar year basis, owns a mineral property from which it extracts minerals containing gold and silver. For each of the four taxable years in the base period it recovered 250,000 tons of a $7.75 ore, i. e. minerals assaying 10 ounces of silver and 0.05 ounce of gold per ton, the price of silver being $0.60 per ounce and of gold being $35 per ounce during such period. The output of silver for each base period year was 2,500,000 ounces, and of gold was 12,500 ounces. The gross income for each base period year was $1,937,500, constituting $1,500,000 attributable to silver and $437,500 attributable to gold. Allowable deductions, including the smelter charges for each year but excluding the allowance for depletion, amounted to $1,000,000. Of the amount of such deductions, $774,193.55 represented the amount allocable to silver production

$$\left(\frac{1,500,000}{1,937,500}\text{ times }\$1,000,000\right)$$

and $225,806.45 represented the amount allocable to gold production

$$\left(\frac{437,500}{1,937,500}\text{ times }\$1,000,000\right).$$

The net income from the mineral property (computed without the allowance for depletion) was $725,806.45 attributable to silver and $211,693.55 attributable to gold. The allowance for percentage depletion computed with respect to silver mining was $225,000 (15 percent of $1,500,000 but not in excess of 50 percent of $725,806.45); the allowance for such depletion computed with respect to gold mining was $65,625 (15 percent of $437,500 but not in excess of 50 percent of $211,693.55). In 1942, 320,000 tons of ore were extracted from the mineral property. The character of the ore encountered had changed so that in 1942 it was $11.375 ore, i. e., minerals which assayed 15 ounces of silver and 0.025 ounce of gold to the ton, the price of silver being $0.70 per ounce and the price of gold $35 per ounce. The total output of silver for 1942 was 4,800,000 ounces; the total output of gold was 8,000 ounces. The gross income for 1942 was $3,640,000, consisting of $3,360,000 attributable to silver and $280,000 attributable to gold. Allowable deductions, including the smelter charges for the year but excluding the allowance for depletion, amounted to $1,280,000. Of the amount of such deductions, $1,181,538.46 represented the amount allocable to silver production

$$\left(\frac{3,360,000}{3,640,000}\text{ times }\$1,280,000\right)$$

and $98,461.54 represented the amount allocable to gold production

$$\left(\frac{280,000}{3,640,000}\text{ times }\$1,280,000\right)$$

The net income from the mineral property (computed without the allowance for depletion) was $2,178,461.54 attributable to silver and $181,538.46 attributable to gold. The allowance for percentage depletion computed with respect to silver mining was $504,000 (15 percent of $3,360,000 but not in excess of 50 percent of $2,178,461.54); the allowance for such depletion computed with respect to gold mining was $42,000 (15 percent of $280,000 but not in excess of 50 percent of $181,538.46). It is estimated that as of December 31, 1942, there were 19,200,000 units of silver and 32,000 units of gold remaining in the mineral property. There is no nontaxable income from exempt excess output of gold, since the normal output exceeds the 1942 output of that metal. The nontaxable income from exempt excess output of silver is $138,220.80, computed as follows:

	Silver	Gold
1. Normal output (ounces):		
a. Silver (10,000,000 divided by 4)	2,500,000	
b. Gold (50,000 divided by 4)		12,500
2. Output for 1942 (ounces)	4,800,000	8,000
3. Excess output (item 1*a* or 1*b*, minus item 2)	2,300,000	0
4. Estimated recoverable unit as of December 31, 1942 (ounces):		
a. Silver (19,200,000 plus 2,300,000)	21,500,000	
b. Gold (32,000 plus 0)		32,000
5. Percentage which item 3 is of item 4*a* or 4*b* (percent)	10.7	0
6. Percentage of item 3 to be used in computing exempt excess output (percent)	30	0
7. Exempt excess output (ounces) (item 3 times item 6)	690,000	0
8. Normal unit profit per ounce (item 17)	$0.20032	$11.68548
9. Nontaxable income from exempt excess output (item 7 times item 8) but not in excess of item 24	$138,220.80	n 0
NORMAL UNIT PROFIT		
10. Gross income from the mineral property for each base period year	$1,500,000.00	$437,500.00
11. Allowable deductions (excluding allowance for depletion) for each base period year	774,193.55	225,806.45
12. Net income from the mineral property (excluding allowance for depletion) for each base period year	725,806.45	211,693.55
13. Allowance for percentage depletion	225,000.00	65,625.00
14. Net income from the mineral property for each base period year	500,806.45	146,068.55
15. Aggregate net income from the mineral property for the base period	$2,003,225.80	$584,274.20
16. Aggregate mineral units recovered during base period (ounces)	10,000,000	50,000
17. Normal unit profit (item 15 divided by item 16)	$0.20032	$11.68548
NET INCOME ATTRIBUTABLE TO EXCESS OUTPUT		
18. Gross income from the mineral property for 1942	$3,360,000.00	$280,000.00
19. Allowable deductions (excluding allowance for depletion) for 1942	1,181,538.46	98,461.54
20. Net income from the mineral property (excluding allowance for depletion for 1942	2,178,461.54	181,538.46
21. Allowance for percentage depletion	504,000.00	42,000.00
22. Net income from the mineral property for 1942	1,674,461.54	139,538.40
23. Unit net income for 1942 (item 22 divided by item 2)	$0.348846	$17.4423
24. Net income attributable to excess output (item 3 times item 23)	$802,345.80	6

If income attributable to a strategic mineral as defined in section 731 is exempt from the excess profits tax pursuant to the provisions of such section, nontaxable income from exempt excess output of such strategic mineral shall not be computed for the purposes of section

735 (b) (1) or of section 711 (a) (1) (I) or section 711 (a) (2) (K). The portion of gross income and allowable deductions attributable to such strategic mineral shall be excluded from the net income from the mineral property in determining the net income attributable to other metals or nonmetallic substances in the minerals recovered from such mineral property for the base period and for the excess profits tax taxable year for which the benefits of section 735 are claimed.

(b) *Coal and iron mines.* With respect to any excess profits tax taxable year beginning after December 31, 1941, the nontaxable income from exempt excess output of a coal mining or an iron mining property which was in operation during the base period shall be whichever of the following amounts the taxpayer elects:

(1) An amount equal to the excess output of such coal mining or iron mining property, determined under this subsection, for such year multiplied by one-half of the unit net income determined under § 35.735–2 (l) from such property for such year, or

(2) An amount determined under § 35.735–3 (a).

In order to elect the amount provided in (1) of this paragraph, the excess output of the coal mining property or iron mining property (as defined in § 35.735–2 (l)) which was in operation during the base period need not exceed 5 percent of the estimated recoverable units in such property. As to the election with respect to the amount provided in (2) of this paragraph, see section 735 (b) (1) and § 35.735–3 (a).

For the purposes of the computation of the amount described in (1) of this paragraph for an excess profits tax taxable year:

A coal mining property or an iron mining property (as defined in § 35.735–2 (l)) shall be considered to have been in operation during the base period if any part of such property was in operation for six months or more during the base period.

The excess output of a coal mining property or an iron mining property which was in operation during the base period shall be computed upon the basis of the coal mining property or the iron mining property and shall be the excess of the aggregate of the mineral units extracted from such coal mining or iron mining property during the taxable year over the normal output of such property. The normal output of a coal mining property or an iron mining property shall be computed with respect to such property in a manner similar to that described in § 35.735–2 (e) with respect to a mineral property, as if such coal mining property or iron mining property were a mineral property.

The election pursuant to section 735 (b) and this paragraph shall be made in the excess profits tax return, filed on or before the last day required by law for the filing of such return, for the taxable year for which the benefits of section 735 are claimed. The last day required by law for the filing of such return includes the last day of the period of any extension of time granted for such filing. Such election must be made for each excess profits tax taxable year for which the benefits of section 735 (b) (2) are claimed. An election made with respect to a taxable year to compute nontaxable income from exempt excess output pursuant to the provisions of section 735 (b) (2) and § 35.735–3 (b) (1) or § 30.735–3 (b) (1) of this chapter does not preclude the taxpayer from electing for a subsequent year to compute nontaxable income pursuant to the provisions of section 735 (b) (1) and § 35.735–3 (a) provided the taxpayer satisfies the requirements there provided, and vice versa. For any excess profits tax taxable year for which an election is made under section 735 (b) (2) and this paragraph, such election shall be made by the taxpayer by attaching to its excess profits tax return a statement showing the method of computation and the amount of nontaxable income from exempt excess output elected under the provisions of section 735 (b) (2) and this paragraph. An election made by the taxpayer pursuant to the provisions of § 30.735–3 (b) of this chapter shall be deemed to be made pursuant to the provisions of this paragraph. If the taxpayer has failed so to elect or desires to change its election, such election or change in election may, subject to the approval of the Commissioner be made by the taxpayer filing with the Commissioner of Internal Revenue, Washington, D. C., within the period of limitations for the filing of claims for credit or refund with respect to the year or years involved, a notice of its election or change in election accompanied by a recomputation of its income and excess profits taxes for such years. If the recomputation results in an overpayment for any of such years, the taxpayer should file a claim for refund on Form 843 in accordance with the provisions of section 322.

The provisions of this paragraph may be illustrated by the following example:

Example. Assume that during the taxable year 1942 a corporation owned several tracts of land containing coal deposits which it had operated for more than six months during the base period. During the taxable year 1942, the coal extracted by the taxpayer from such land was processed at a single preparation plant, so that for the purposes of the computation provided by (1) of this paragraph such land constitutes a coal mining property. The normal output of the coal mining property was 350,000 tons. The output for the calendar year 1942 was 450,000 tons. The net income from the coal mining property during 1942 was $103,500. Assume that for the year 1942, the corporation elected to compute an amount of nontaxable income from exempt excess output of the coal mining property under the rule prescribed by (1) of this paragraph rather than under (2) of this paragraph. Such amount of nontaxable income from exempt excess output would be $11,500, computed as follows:

1. Normal output (tons)	350,000
2. Output for 1942 (tons)	450,000
3. Excess output (tons) (item 2 less item 1)	100,000
4. Net income from coal extracted from coal mining property in 1942	$103,500.00
5. Unit net income per ton for 1942 (item 4 divided by item 2)	$0.23
6. Nontaxable income from exempt excess output computed pursuant to section 735(b)(2) and without regard to section 735 (b) (1) (item 3 times one-half of item 5)	$11,500.00

(c) *Timber properties.* The nontaxable income from exempt excess output of a timber block which was in operation during the base period shall be an amount equal to the excess output of such timber block for such year, determined under § 35.735–2 (d), multiplied by one-half of the unit net income from such timber block for such year, determined under § 35.735–2 (l).

The provisions of this paragraph may be illustrated by the following example:

Example. Assume that the normal unit output of a timber block operated by Corporation T during the base period was 20,000,000 board feet log scale. The output of timber units for the taxable year 1942 was 32,000,000 board feet log scale and the net income attributable to the timber block, and to timber and logging operations, not including transportation, was $320,000. The nontaxable income from exempt excess output of the timber block for 1942 is $60,000, computed as follows:

1. Normal output (M board feet log scale)	20,000
2. Timber units for 1942 (M board feet log scale)	32,000
3. Excess output (M board feet log scale)	12,000
4. Net income from timber block for 1942	$320,000
5. Unit net income per M board feet log scale for 1942 (item 4 divided by item 2)	$10
6. Nontaxable income from exempt excess output computed pursuant to section 735 (b) (3) (item 3 multiplied by one-half of item 5)	$60,000

§ 35.735–4 *Nontaxable bonus income.* The term "nontaxable bonus income" means the amount of the income derived from bonus payments made by any agency of the United States Government on account of the production in excess of certain specified quotas of a mineral product or of timber, if the exhaustion of the mineral property or the timber block from which such product or timber was recovered gives rise to an allowance for depletion under section 23 (m). Such amount, however, shall not exceed the net income (computed with the allowance for depletion) attributable to the output in excess of the quota. Such net income so attributable shall be an amount which bears the same ratio to the net income from the mineral property, computed as provided in § 35.735–2 (l), or the net income from the timber block, computed as provided in § 35.735–2 (l), as the output in excess of the quota bears to the total number of mineral units or timber units produced for the taxable year. If two or more metals, coal, or nonmetallic substances are contained in the minerals recovered from a mineral property, nontaxable bonus income must be determined with respect to each such metal, coal, or nonmetallic substance, and net income from the property must be allocated fairly between each type of metal, coal, or nonmetallic substance. In the case of

any such bonus paid with respect to any such type of metal, coal, or nonmetallic substance the nontaxable bonus income shall not exceed the net income attributable to the output in excess of the specified quota of such type. Such net income shall be an amount which bears the same ratio to the net income attributable to such type of metal, coal, or nonmetallic substance as the output in excess of the quota established for such type bears to the number of mineral units of such type produced for the taxable year.

The provisions of this section may be illustrated by the following example:

Example. Corporation C, which is on the calendar year basis, owns a mineral property from which is extracted copper ore. For each of the four years in the base period, it extracted 200 tons of ore a day, or 73,000 tons per year; the ore assayed 60 pounds of copper to the ton. The annual base period output of copper was 4,380,000 pounds, and the price received by Corporation C per ton of ore was $7.20. Gross income for each base period year was therefore $525,600. Allowable deductions, including the smelter charges but exclusive of percentage depletion, amounted to $385,000. Net income from the mineral property, without regard to the allowance for depletion, was $140,600. Percentage depletion for each such year amounted to $70,300 (15 percent of $525,600 but not in excess of 50 percent of $140,600). For 1942, Corporation C recovered 110,000 tons of ore, which assayed 50 pounds of copper to the ton, from the mineral property. The 1942 output of copper was therefore 5,500,000 pounds. The ceiling price established by the War Production Board and the Office of Price Administration for copper was $0.12 per pound. With respect to Corporation C, a 1942 quota of 4,000,000 pounds of copper was established and a bonus of $0.05 per pound was paid for above-quota production. Gross income received by Corporation C for 1942 was $735,000 and included a bonus payment of $75,000 (1,500,000 times $0.05). Allowable deductions, including the smelter charges but exclusive of percentage depletion, amounted to $579,700. Net income from the property, without regard to the allowance for depletion, was $155,300. Percentage depletion amounted to $77,650 (15 percent of $735,000 but not in excess of 50 percent of $155,300). As of December 31, 1942, it was estimated that 35,000,000 pounds of copper remained in the minerals in the mineral property. Since the excess output for 1942 did not exceed 5 percent of the estimated recoverable units for 1942, nontaxable income from exempt excess output is not authorized by section 735 (b) (1). The amount of nontaxable bonus income for 1942 is $21,177, computed as follows:

1. Normal output (pounds) (17,520,000 divided by 4)	4,380,000
2. Output for 1942 (pounds)	5,500,000
3. Excess output for 1942 (pounds) (item 2 minus item 1)	1,120,000
4. Estimated recoverable units for 1942 (pounds) (35,000,000 plus item 3)	36,120,000
5. Percentage which item 3 is of item 4 (percent)	3.1
6. Gross income for 1942 from the mineral property	$735,000
7. Allowable deductions (excluding depletion)	$579,700
8. Net income from the mineral property (excluding depletion)	$155,300
9. Less percentage depletion	$77,650
10. Net income for 1942 from the mineral property	$77,650
11. Unit net income for 1942 (item 10 divided by item 2)	$0.014118
12. Quota for 1942 (pounds)	4,000,000
13. Above-quota production for 1942 (pounds) (item 2 minus item 12)	1,500,000
14. Net income attributable to above-quota production (item 13 times item 11)	$21,177
15. Bonus payments received	$75,000
16. Nontaxable bonus income (item 14 or item 15, whichever is the lesser)	$21,177

If income attributable to a strategic mineral as defined in section 731 is exempt from excess profits tax pursuant to the provisions of such section, nontaxable bonus income attributable to such strategic mineral shall not be computed for the purposes of section 735 (c) or of section 711 (a) (1) (I) or section 711 (a) (2) (K). The portion of gross income and allowable deductions attributable to such strategic mineral shall be excluded from the net income from the mineral property in determining the net income attributable to other metals or nonmetallic substances in the minerals recovered from such mineral property for the base period and for the excess profits tax taxable year for which the benefits of section 735 are claimed.

§ 35.735–5 *Rule in case income from excess output includes bonus payment.* The nontaxable income attributable to exempt excess output pursuant to the provisions of section 735 (b) (1), (2), or (3) may include nontaxable bonus payments, as provided in section 735 (c). In such case, the taxpayer may elect to compute its nontaxable income attributable to the output in excess of the established quota as nontaxable income from exempt excess output pursuant to the appropriate provision of section 735(b) and § 35.735–3 or as nontaxable bonus income pursuant to section 735 (c) and § 35.735–4. Such election shall be made in the excess profits tax return filed prior to the last day prescribed by law for the filing of such return for the taxable year for which the benefits of section 735 are claimed. The last day prescribed by law for the filing of the return includes the last day of the period of any extension granted for such filing. The election provided in section 735(d) must be made for each excess profits tax taxable year for which income attributable to excess output includes bonus payments. An election made with respect to one excess profits tax taxable year to receive the benefits of nontaxable bonus income under section 735(c) does not preclude the taxpayer from electing for a subsequent year to receive the benefits of nontaxable income from exempt excess output under section 735(b), and vice versa. For any excess profits tax taxable year for which an election is made under section 735(d) and this section, such election shall be made by the taxpayer by attaching to its excess profits tax return a statement showing the method of computation and the amount of nontaxable income from exempt excess output under section 735 (b) or of nontaxable bonus income under section 735 (c) whichever the taxpayer elects to exclude under section 711 (a) (1) (I) or section 711 (a) (2) (K) in the computation of excess profits net income. An election made by the taxpayer pursuant to the provisions of § 30.735–5 of this chapter shall be deemed to be made pursuant to the provisions of this section. If the taxpayer has failed so to elect or desires to change its election, such election or change in election may, subject to the approval of the Commissioner, be made in an amended return filed by the taxpayer within the period of limitations for the filing of claims for credit or refund.

The provisions of this section may be illustrated by the following example:

Example. Corporation P, which is on the calendar year basis, owns a mineral property from which is extracted minerals containing lead and silver. For each taxable year in the base period, 10,000 tons of ore assaying 100 pounds of lead and 10 ounces of silver to the ton, were extracted from the mineral property. The output of lead for each base period year was 1,000,000 pounds; the output of silver was 100,000 ounces. Assume that the market price obtained by such corporation for lead for such period was $0.05 per pound and that the market price obtained for silver was $0.70 per ounce. The gross income for each year in the base period was $120,000, consisting of $50,000 received for lead and $70,000 for silver. Allowable deductions for each year, including the smelter charges but excluding the allowance for depletion, amounted to $40,000. Of the amount of such deductions, $16,666.67 represented the amount allocable to lead production $\left(\frac{50,000}{120,000} \text{ times } \$40,000\right)$ and $23,333.33 represented the amount allocable to silver production $\left(\frac{70,000}{120,000} \text{ times } \$40,000\right)$. The net income from the mineral property (computed without the allowance for depletion) was $33,333.33 attributable to lead, and $46,666.67 attributable to silver. The allowance for percentage depletion computed with respect to lead mining was $7,500 (15 percent of $50,000 but not in excess of 50 percent of $33,333.33); the allowance for such depletion computed with respect to silver mining was $10,500 (15 percent of $70,000 but not in excess of 50 percent of $46,666.67). In 1942, 20,000 tons of ore were extracted from the mineral property. The quality of the ore had deteriorated so that it assayed 80 pounds of lead and 8 ounces of silver to the ton. For 1942, therefore, the total output of lead was 1,600,000 pounds, and the total output of silver was 160,000 ounces. The ceiling price of lead was $0.06½ per pound; a quota of 900,000 pounds of lead was established by the War Production Board and the Office of Price Administration with respect to the taxpayer and a bonus of $0.02¾ per pound was paid to the taxpayer with respect to production in excess of such quota. The price of silver obtained by taxpayer was $0.70 per ounce. The gross income for 1942 was $235,250 consisting of $123,250 attributable to lead and $112,000 attributable to silver. The bonus payments received by the taxpayer with respect to above-qouta production of lead, included in gross income attributed to lead, amounted to $19,250 (700,000 pounds of lead times $0.02¾ per pound). Allowable deductions for the year, including the smelter charges but excluding the allowance for depletion, amounted to $80,000. Of the amount of such deductions, $41,912.86 represented the

amount allocable to lead production $\left(\frac{123,250}{235,250}\right.$ times $80,000$) and $38,087.14 represented the amount allocable to silver production $\left(\frac{112,000}{235,250}\right.$ times $80,000$)$. The net income from the mineral property (computed without the allowance for depletion) was $81,337.14 attributable to lead and $73,912.86 attributable to silver. The allowance for percentage depletion computed with respect to lead mining was $18,487.50 (15 percent of $123,250 but not in excess of 50 percent of $81,337.14); the allowance for such depletion computed with respect to silver mining was $16,800 (15 percent of $112,000 but not in excess of 50 percent of $73,912.86). It is estimated that as of December 31, 1942, there were 6,500,000 pounds of lead and 510,000 ounces of silver remaining in the mineral property. For 1942 the amount of nontaxable income from exempt excess output of lead was $3,099.60, the amount of nontaxable bonus income from lead was $19,250, and the amount of nontaxable income from exempt excess output of silver was $6,510.06.

Since the amount of nontaxable bonus income with respect to the output of lead which exceeds the established quota and which also constitutes excess output, i. e., 600,000 pounds, was $16,500 (item 33 in the following computation) and exceeded $3,099.60, representing the nontaxable income from exempt excess output of lead, Corporation P elected under section 735(d) to exclude $16,500 with respect to such 600,000 pounds in the computation of excess profits net income. With respect to the remaining portion of its output in excess of the established quota, i. e., 100,000 pounds, Corporation P excluded nontaxable bonus income of $2,750 (item 34) in the computation of excess profits net income pursuant to section 735(c).

COMPUTATION

	Lead	Silver
1. Normal output:		
a. Lead (pounds) (4,000,000 divided by 4)	1,000,000	
b. Silver (ounces) (400,000 divided by 4)		100,000
2. Output for 1942	1,600,000	160,000
3. Excess output (item 2, minus item 1a or 1b)	600,000	60,000
4. Estimated recoverable units as of December 31, 1942:		
a. Lead (pounds) (6,500,000 plus 600,000)	7,100,000	
b. Silver (ounces) (510,000 plus 60,000)		570,000
5. Percentage which item 3 is of item 4a or 4b (percent)	8.45	10.53
6. Percentage of item 3 to be used in computing exempt excess output (percent)	20	
7. Exempt excess output (item 3 times item 6)	120,000	18,000
8. Normal unit profit (item 17)	$0.02583	$0.36167
9. Nontaxable income from exempt excess output (item 7 times item 8) but not in excess of item 24	$3,099.60	$6,510.06
NORMAL UNIT PROFIT		
10. Gross income from the mineral property for each base period year	$50,000.00	$70,000.00
11. Allowable deductions (excluding allowance for depletion) for each base period year	16,666.67	23,333.33
12. Net income from the mineral property (excluding allowance for depletion) for each base period year	33,333.33	46,666.67
13. Allowance for percentage depletion	7,500.00	10,500.00
14. Net income from the mineral property for each base period year	25,833.33	36,166.67
15. Aggregate net income from the mineral property for the base period	103,333.32	144,666.68

COMPUTATION—Continued

	Lead	Silver
NORMAL UNIT PROFIT—con.		
16. Aggregate mineral units recovered during the base period	4,000,000	400,000
17. Normal unit profit (item 15 divided by item 16)	$0.02583	$0.36167
NET INCOME ATTRIBUTABLE TO EXCESS OUTPUT		
18. Gross income from the mineral for 1942	$123,250.00	$112,000.00
19. Allowable deductions (excluding allowance for depletion) for 1942	41,912.86	38,087.14
20. Net income from the mineral property (excluding allowance for depletion) for 1942	81,337.14	73,912.86
21. Allowance for percentage depletion	18,487.50	16,800.00
22. Net income from the mineral property for 1942	62,849.64	57,112.86
23. Unit net income for 1942 (item 22 divided by item 2)	$0.03928	$0.35696
24. Net income attributable to excess output for 1942 (item 3 times item 23)	$23,568.00	$21,417.60
NONTAXABLE BONUS INCOME		
	Lead	
25. Quota established for 1942 (pounds)	900,000	
26. Total output for 1942 (pounds)	1,600,000	
27. Above-quota output (pounds)	700,000	
28. Bonus payments received (item 27 times $0.02¾)	$19,250	
29. Net income attributable to above-quota output (item 27 times item 23)	$27,496	
30. Nontaxable bonus income (item 28 or item 29, whichever is the lesser)	$19,250	
COMPUTATION OF NONTAXABLE INCOME FROM EXEMPT EXCESS OUTPUT AND FROM BONUS PAYMENTS WITH RESPECT TO 1942 EXCESS OUTPUT IN EXCESS OF QUOTA		
31. Item 3 or item 27, whichever is the lesser	600,000	
32. Nontaxable income from exempt excess output computed with respect to item 31 (item 9)	$3,099.60	
33. Nontaxable bonus income computed with respect to item 31 (item 31 times $0.02¾)	$16,500.00	
34. Nontaxable bonus income computed with respect to above-quota output in excess of 600,000 pounds, i. e., 100,000 times $0.02¾ (item 30 minus item 33)	$2,750.00	

SEC. 736. RELIEF FOR INSTALLMENT BASIS TAXPAYERS AND TAXPAYERS WITH INCOME FROM LONG-TERM CONTRACTS. [Added by sec. 222 (d), Rev. Act 1942.]

(a) *Election to accrue income.* In the case of any taxpayer computing income from installment sales under the method provided by section 44 (a), if such taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that the average volume of credit extended to purchasers on the installment plan in the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per centum of the volume of such credit extended to such purchasers in the taxable year, or the average outstanding installment accounts receivable at the end of each of the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per centum of the amount of such accounts receivable at the end of the taxable year, or if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, in either case including only such years for which the income was computed under the method provided in section 44 (a), it may elect, in its return for the taxable year, for the purposes of the tax imposed by this subchapter, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, its income from installment sales on the basis of the taxable period for which such income is accrued, in lieu of the basis provided by section 44 (a). Except as hereinafter provided, such election shall be irrevocable when once made and shall apply also to all subsequent taxable years, and the income from installment sales for each taxable year before the first year with respect to which the election is made but beginning after December 31, 1939, shall be adjusted for the purposes of this subchapter to conform to such election. In making such adjustments, no amount shall be included in computing excess profits net income for any excess profits tax taxable year on account of installment sales made in taxable years beginning before January 1, 1940. If the taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that in a taxable year subsequent to the year with respect to which an election has been made under the preceding provisions of this subsection it would not be eligible to elect such accrual method, the taxpayer may in accordance with such regulations elect in its return for such year to abandon such accrual method. Such election shall be irrevocable when once made and shall preclude any further elections under this subsection. For the taxable year for which the latter election is made and subsequent taxable years, income shall be computed in accordance with section 44 (c).

§ 35.736 (a)-1 *Taxpayers reporting income on installment basis; eligibility for relief*—(a) *In general.* Section 736 (a) provides excess profits tax relief with respect to a taxpayer which computes its income for the taxable year from installment sales under the method provided by 44 (a), if such taxpayer establishes that either:

(1) The average volume of credit extended to purchasers on the installment plan in the four taxable years preceding the first taxable year of the taxpayer beginning after December 31, 1941, was more than 125 percent of the volume of such credit extended to such purchasers in the taxable year, or

(2) The average outstanding installment accounts receivable at the end of each of the four taxable years preceding the first taxable year of the taxpayer beginning after December 31, 1941, was more than 125 percent of the amount of such accounts receivable at the end of the taxable year.

If the taxpayer was not in existence for the four taxable years preceding its first taxable year beginning after December 31, 1941, the average volume of credit or the average outstanding installment accounts, as the case may be, for the years preceding such first taxable year shall be computed for such years as the taxpayer was in existence. The average volume of credit or the average outstanding installment accounts shall be computed only with respect to those years for which the income was computed pursuant to the method provided by section 44 (a), and shall not be computed with respect to any year for which the income was reported on the cash or the straight accrual basis. The years with respect to which such computations are made need not be consecutive taxable years.

The average volume of credit for the appropriate years preceding the taxpayer's first taxable year beginning after December 31, 1941 (hereinafter called the "installment base period"), shall be the aggregate of the volumes of credit extended during each of such years divided

by the number of months in such years and multiplied by 12. If the taxable year with respect to which the election is being made is a year of less than 12 months, the number of months in such year shall be used for the purposes of the preceding sentence instead of 12. The average outstanding installment accounts receivable shall be the aggregate of the amounts of the installment accounts receivable at the end of each of the taxable years in the installment base period divided by the number of years in such period.

(b) *Definitions and determinations.* For the purposes of this section:

(1) An installment sale means any sale upon credit which the purchaser agrees to repay in two or more scheduled payments, regardless of the maturity of such credit or the amount of the down payment or of each payment, and which for the purposes of the income tax under Chapter 1 is reported on the installment basis. An installment sale shall not include any casual sale of personal property, and shall not include any sale of real property unless the initial payments received in cash or property (other than evidences of indebtedness of the purchaser) during the taxable period in which the sale is made do not exceed 30 percent of the selling price and unless the taxpayer is regularly engaged in the business of selling real property upon such basis.

(2) The volume of credit for a taxable year is the amount equal to the difference between the amount of net sales (gross sales minus sales returns and allowances) and the amount of the down payments in cash or in other property (other than evidence of indebtedness of the purchaser). The sales price of an article shall include the amount of any service or credit charge but shall not include the amount of any sales tax or other excise tax imposed upon the sale whether or not charged to the purchaser. The down payment shall be the payment made at the time of the sale and shall not include the amount of any sales tax or other excise tax charged to the purchaser and included in the down payment.

(3) The outstanding accounts receivable at the end of a taxable year shall be the aggregate of the net debit amounts in the installment accounts receivable of the taxpayer at the end of such taxable year. Installment accounts receivable shall be the accounts reflecting the amounts due the taxpayer from installment sales. In computing the net debit amount of such accounts for the installment base period there shall be allowed as credits not only payments, trade-ins, and returns and allowances but also the amount of installment accounts receivable which have been ascertained to be worthless and have been charged off under section 23 (k) of the Revenue Act of 1938 and have been allowed as a deduction in computing the net income, or which have become worthless under section 23 (k) (1) of the Internal Revenue Code and have been allowed as a deduction. With respect to the taxable year for which eligibility for relief under section 736 (a) and this section is being determined, in addition to the credits for payments, trade-ins, and returns and allowances, there shall be allowed as a credit the amount of installment accounts receivable which have been determined to be worthless under section 23 (k) (1) of the Internal Revenue Code and which have been allowed as a deduction in computing the net income for such year. In determining the amount of installment accounts receivable at the end of the taxable year for which eligibility for relief under section 736 (a) is being determined, no credit shall be allowed based upon the sale, hypothecation, or other disposition (other than by payment by the purchaser) of any installment account receivable unless it is the practice of the taxpayer to sell, hypothecate, or make other disposition of a portion of its installment accounts receivable, and unless such sales, hypothecations, or other dispositions have been made in the installment base period. If such sales, hypothecations, or other dispositions have been made in such period, credits may be allowed in computing the amount of installment accounts receivable at the close of the taxable year for which eligibility is being determined. Such credit, however, shall not exceed an amount which bears the same ratio to the installment accounts receivable at the close of the taxable year which the total credit attributable to sales, hypothecations, or other dispositions (other than by payment by the purchaser) during the taxable years in the installment base period bears to the aggregate of the installment accounts receivable at the end of each of the taxable years in such period.

§ 35.736 (a)–2 *Election to compute excess profits income on straight accrual basis.* If a taxpayer computing income from installment sales under the method provided by section 44(a) establishes eligibility for relief in accordance with the provisions of section 736(a) and § 35.736(a)–1, it may elect in its excess profits tax return for such year to compute income attributable to installment sales on the basis of the taxable period for which such income is accrued, in lieu of the basis provided by section 44(a), pursuant to which income for any taxable year is determined to be that proportion of the installment payments actually received during the year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

A taxpayer electing to compute income from installment sales on the basis of the taxable period for which such income is accrued, pursuant to section 736 (a) and this section, must file with its excess profits tax return for the year in which such election is made the following:

(a) A statement of the taxable years in the installment base period for which income from installment sales was reported for the purposes of the income tax under Chapter 1 under the method provided by section 44(a) and a statement that for the taxable year income from such sales is reported upon such basis for purposes of the income tax under Chapter 1.

(b) A schedule setting forth in columnar form the details of the computation of the volume of credit extended to purchasers on the installment plan in the taxable year and in each taxable year in the installment base period or of the amount of the outstanding installment accounts receivable at the end of the taxable year and at the end of each taxable year in the installment base period, or both, and the computation of the ratio between such volume of credit extended in the taxable year and in the installment base period, or between such outstanding accounts receivable at the end of the taxable year and the average of such outstanding accounts for the installment base period, or both.

(c) A schedule setting forth the installment accounts receivable which have been sold, hypothecated, or otherwise disposed of during the taxable year and during the installment base period, and the ratio that such sales, hypothecations or other dispositions bear to installment accounts receivable outstanding at the close of the taxable year and at the end of each taxable year of the installment base period.

(d) Amended income and excess profits tax returns for each taxable year beginning after December 31, 1939, and prior to the taxable year for which the election is made, to reflect the effects of the computation of income from installment sales for the purposes of the excess profits tax for such years on the basis of the taxable period for which such income is accrued. If the recomputation produces an overassessment for any of such years, the taxpayer should file a claim for refund on Form 843 with the amended returns for such years.

An election made by the taxpayer pursuant to the provisions of § 30.736 (a)–2 of this chapter shall be deemed to be made pursuant to the provisions of this section.

If the taxpayer elects under the provisions of section 736 (a) and this section to compute its income from installment sales on the straight accrual basis, such election shall be irrevocable when once made and shall apply also to all subsequent taxable years and the income from installment sales for each taxable year before the first year with respect to which the election is made, but beginning after December 31, 1939, shall be adjusted for the purposes of the excess profits tax computation to conform to such election. Since no change in the computation of income from the installment basis to the straight accrual basis can be made for any year beginning prior to January 1, 1940, as a result of such election, no recomputation can be made for any year in the base period. If the taxpayer uses the excess profits credit based on income pursuant to section 713 or section 742, the average base period net income shall be the actual average base period net income with income from installment sales computed under the method pursuant to which such income was reported for the purposes of the income tax under Chapter 1 for the taxable years in such period. If the taxpayer uses the excess profits credit based on

invested capital pursuant to section 714, the determination of accumulated earnings and profits shall be made without regard to any adjustment resulting from election made under section 736 (a) and this section, except as such election is reflected in the amount of income tax or excess profits tax payable for taxable years beginning after December 31, 1939. The election made pursuant to section 736 (a) and this section to compute income on the straight accrual basis in lieu of the basis provided in section 44 (a) shall apply only with respect to excess profits net income for purposes of the excess profits tax imposed by Subchapter E of Chapter 2. For purposes of the income tax under Chapter 1, or the surtax on personal holding companies or the declared value excess profits tax under Chapter 2, income shall be computed upon the basis provided in section 44 (a).

If the taxpayer does not satisfy the eligibility requirements of section 736 (a) and § 35.736 (a)–1 for its first taxable year beginning after December 31, 1941, it is not precluded from electing for any subsequent taxable year in which it satisfies such eligibility requirements to compute its income from installment sales upon the straight, accrual basis. Moreover, the taxpayer need not elect under section 736 (a) and this section to compute its income from installment sales upon the straight accrual basis for the first taxable year beginning after December 31, 1941, with respect to which such eligibility requirements are satisfied. Failure so to elect does not preclude an election for a subsequent taxable year with respect to which the eligibility requirements are met.

For a new election to return to the installment basis of reporting income for a taxable year in which the taxpayer would not be eligible to elect to compute income from installment sales on the straight accrual basis pursuant to section 736(a) and this section subsequent to the year in which such election was made, see § 35.736(a)–4.

§ 35.736 (a)–3 *Computation of income on straight accrual basis.* If the taxpayer has elected under section 736(a) and section 35.736(a)–2 to compute for excess profits tax purposes its income from installment sales on the basis of the taxable year for which such income is accrued, in lieu of the basis provided by section 44 (a), the gross income of the taxpayer from installment sales shall be computed upon such accrual basis. Likewise all deductions under section 23 allowable in computing net income and attributable to such sales, shall be computed upon the straight accrual basis. However, no income or deductions (including deductions for bad debts) shall be included in the computation of excess profits net income for any excess profits tax taxable year on account of installment sales made in taxable years beginning before January 1, 1940.

Any deductions under section 23 which are limited to a percentage of net income (computed without regard to such deductions, as for example, the deduction for charitable contributions which is allowed by section 23(q) shall be determined on the basis of such net income with income from installment sales determined upon the straight accrual basis, and not on the basis of such net income for the purposes of the income tax under Chapter 1. The deduction for bad debts under section 23(k) shall be allowed only with respect to debts which have become worthless within the taxable year. No reserve for bad debts arising from installment accounts receivable may be set up for excess profits tax purposes, and no bad debt deduction shall be allowed for any additions to such a reserve. Only those debts which have become worthless within the taxable year and which are allowed as a deduction in the computation of net income for the purposes of the income tax under Chapter 1 for the taxable year shall be allowed in the determination of the bad debt deduction for excess profits tax purposes under section 736(a). If a debt reflected in installment accounts receivable was created in a prior excess profits tax taxable year for which the income for excess profits tax purposes was computed upon the straight accrual basis or was recomputed upon the straight accrual basis pursuant to an election made under section 736(a) and § 35.736(a)–2, and the total amount of the profit represented by such installment accounts receivable was included in gross income for such year, the amount of the deduction for the bad debt shall be computed upon the straight accrual basis and shall not be limited to the unrecovered cost of the goods or article sold in consideration of such debt.

In computing the net operating loss deduction for the purposes of the excess profits tax for a taxable year pursuant to section 23 (s), section 122, and section 711 (a) (1) (J) or section 711 (a) (2) (L):

(a) The net operating loss under section 122 (a) for any prior or subsequent taxable year and the net income under section 122 (b) for any prior taxable year shall be determined by computing income from installment sales upon the straight accrual basis if for the purposes of the excess profits tax for such prior or subsequent years the income would be so computed upon the straight accrual basis pursuant to an election made under section 736 (a) and § 35.736 (a)–2;

(b) The net operating loss under section 122 (a) for any subsequent taxable year shall be determined by computing income from installment sales upon the installment method provided by section 44 (a) if for the purposes of the excess profits tax for such year income from installment sales would be so computed under the method provided by section 44 (a) pursuant to an election made under section 736 (a) to abandon the straight accrual method (see § 35.736 (a)–4);

(c) The net operating loss for a taxable year beginning in 1939 shall be the net operating loss determined under the provisions of Chapter 1 applicable to such year, without regard to any election subsequently made under section 736 (a);

(d) The excess profits net income for the taxable year in which the net operating loss deduction is computed shall, for the purposes of the reduction provided by section 711 (a) (1) (J) (ii) or section 711 (a) (2) (L) (ii) be determined by computing income from installment sales under the straight accrual basis pursuant to the election made under section 736 (a) and § 35.736 (a)–2.

In computing normal tax net income for the purposes of determining excess profits net income, the credit for dividends received shall be limited to 85 percent of the adjusted net income computed by placing income from installment sales on the straight accrual basis as provided in this section, instead of on the installment basis.

The unused excess profits credit under section 710 (c) (2) for any excess profits tax taxable year for which the excess profits net income is computed by determining income from installment sales on the straight accrual basis pursuant to the election exercised under section 736 (a) and § 35.736 (a)–2 shall be computed with regard to the excess profits net income so computed. For any excess profits tax taxable year for which income from installment sales is computed under the method provided by section 44 (a), pursuant to an election under section 736 (a) and § 35.736 (a)–4 to abandon the straight accrual basis, the unused excess profits credit shall be computed with regard to the excess profits net income so computed. The adjusted excess profits net income used in the computation of the unused excess profits carry-back and carry-over under section 710 (c) (3) shall be the adjusted excess profits net income computed by determining income from installment sales on the straight accrual basis as described in this section. The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits credit carry-backs to such taxable year, and shall be applied against excess profits net income for such year computed by determining income from installment sales on the straight accrual basis. However, no unused excess profits credit carry-back may be used against excess profits net income for an excess profits tax taxable year beginning prior to January 1, 1941, regardless of the fact that the excess profits net income for such year had been increased by income from installment sales computed on the straight accrual basis, whereas if such income had been computed on the installment basis the income from installment sales would be attributable to a subsequent taxable year to which an unused excess profits credit carry-back would be allowed. For the computation of the unused excess profits credit adjustment, see section 710 (c) and § 35.710–4.

If an election is made under section 736 (a) and § 35.736 (a)–2 for an excess profits tax taxable year beginning after December 31, 1941, or for a subsequent taxable year, to compute excess profits

net income on the straight accrual basis in lieu of the installment basis, the following rules shall apply with respect to a taxable year beginning after December 31, 1941: The normal tax and surtax determined under Chapter 1 shall be based upon normal tax net income and surtax net income which include income from installment sales computed under the method provided by section 44 (a), and the excess profits tax shall be determined upon the basis of adjusted excess profits net income which shall include income from installment sales computed upon the straight accrual basis as described in this section. The normal tax net income and the corporation surtax net income for the purposes of the normal tax and surtax under Chapter 1 shall be determined by using as the credit under section 26 (e) (relating to income subject to excess profits tax) the amount of adjusted excess profits net income computed by determining income from installment sales upon the straight accrual basis. For the purposes of determining the excess profits tax under section 710 (a) (1) (B), as an amount which when added to the normal tax and surtax for such year equals 80 percent of the corporation surtax net income computed without regard to the credit under section 26 (e) the corporation surtax net income shall include income from installment sales computed upon the straight accrual basis described in this section, the credit for dividends received used in computing corporation surtax net income shall be limited to 85 percent of the net income which shall include income from installment sales computed upon such straight accrual basis, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1.

For rules applicable to taxable years beginning in 1940 and 1941 where an election is made under section 736 (a) and § 35.736 (a)–2 for an excess profits tax taxable year beginning after December 31, 1941, or for a subsequent taxable year, to compute excess profits net income on the straight accrual basis in lieu of the installment basis, see § 30.736 (a)–3 of this chapter.

The income tax and excess profits tax for any taxable year recomputed as provided in this section pursuant to the election under section 736 (a) shall be the income tax and the excess profits tax for such year for the purposes of the provisions of Supplement L of Chapter 1, relating to assessment and collection of deficiency, the provisions of Supplement M of Chapter 1, relating to interest and additions to the tax, and the provisions of Supplement O of Chapter 1, relating to overpayments. Any amount of excess profits tax deferred under section 710 (a) (5) on account of relief claimed under section 722, any amount of foreign tax credit under section 729 (c) and (d) which is limited to a portion of the excess profits tax imposed, any credit for debt retirement under section 783, and any amount of post war refund under section 780 shall be computed with respect to the excess profits tax so determined. Likewise, any amount of foreign tax credit under section 131 which is limited to a portion of the income tax imposed shall be computed with respect to the income tax so determined.

The provisions of this section may be illustrated by the following example:

Example. Corporation I, which came into existence early in 1936, is a retail dealer selling personal property on the installment plan. It computes its income on the calendar year basis under the method provided in section 44 (a). It has established that the average outstanding installment accounts receivable at the end of the years 1938, 1939, 1940, and 1941 is more than 125 percent of the amount of outstanding installment accounts receivable at the end of 1942. It therefore elects under section 736 (a) and § 35.736 (a)–2 to compute its income from installment sales upon the straight accrual basis for purposes of the excess profits tax for the year 1942; income from such sales for the years 1940 and 1941 must also be computed upon the straight accrual basis. The net income of Corporation I from installment sales computed upon the installment method and upon the straight accrual basis, the deductions (not including any deduction for excess profits tax) and the amount of income which will not be subject to excess profits tax as a result of the election under section 736 (a) are shown in the following schedule:

Taxable year	Income accrued	Years in which income is realized by collection and reported upon the installment basis							Unrealized income Dec. 31, 1942
		1936	1937	1938	1939	1940	1941	1942	
1936	$200,000	$70,000	$50,000	$50,000	$30,000				
1937	300,000		100,000	100,000	50,000	$50,000			
1938	350,000			120,000	150,000	50,000	$30,000		
1939	400,000				150,000	100,000	100,000	$50,000	
1940	450,000					200,000	150,000	100,000	
1941	480,000						250,000	200,000	$30,000
1942	540,000							500,000	40,000
Income	2,720,000	70,000	150,000	270,000	380,000	400,000	530,000	850,000	70,000
Deductions	530,000	50,000	60,000	65,000	75,000	90,000	90,000	100,000	
Net income	2,190,000	20,000	90,000	205,000	305,000	310,000	440,000	750,000	70,000

	1940	1941	1942	Unrealized income Dec. 31, 1942
Net income from installment sales for taxable years beginning after December 31, 1939, computed upon installment basis	$400,000	$530,000	$850,000	$70,000
Net income from installment sales for taxable years beginning after December 31, 1939, computed upon accrual basis	450,000	480,000	540,000	
Increase in excess profits net income caused by change to accrual basis	50,000			
Decrease in excess profits net income caused by change to accrual basis		50,000	310,000	70,000

Income subject to excess profits tax upon installment basis (sum of incomes for 1940, 1941, 1942, and income unrealized as of December 31, 1942)	$1,850,000
Income subject to excess profits tax upon accrual basis (sum of incomes for 1940, 1941, and 1942)	1,470,000
Income which is not subject to excess profits tax if election is made under section 736 (a) to compute income from installment sales upon the accrual method	380,000

Assume, for the purpose of computing tax for 1942, that except for the credit for income subject to excess profits tax, there are no adjustments to net income shown in the preceding schedule in computing normal tax net income, corporation surtax net income, or excess profits net income, and that dividends out of earnings and profits were distributed for each year in the base period equal to the amount of the net income for such year. The average base period net income pursuant to section 713 (d) and (f) for 1942 is $305,000, i. e., one-half of the sum of $205,000 (the income for 1938), $305,000 (the income for 1939), and $200,000 (one-half of the amount by which the aggregate of the incomes for 1938 and 1939 exceeds the aggregate of the incomes for 1936 and 1937), but not in excess of $305,000. The excess profits credit based on income for such year is $289,750 (95 percent of $305,000). The income tax and excess profits tax computed for 1942 without regard to section 736 (a) and pursuant to an election under section 736 (a) would be as follows:

Income tax

Without regard to section 736 (a)

1. Net income (installment basis)	$750,000
2. Less: Credit under section 26 (e) for income subject to excess profits tax (item 16)	455,250
3. Normal tax net income and corporation surtax net income	294,750
4. Normal tax (24 percent)	70,740
5. Surtax (16 percent)	47,160
6. Total tax	117,900

Income tax—Continued

Pursuant to election under section 736 (a)

7. Net income (installment basis)	$750,000
8. Less credit under section 26 (e) for income subject to excess profits tax (item 21)	145,250
9. Normal tax net income and corporation surtax net income	604,750
10. Normal tax (24 percent)	145,140
11. Surtax (16 percent)	96,760
12. Total tax	241,900

Excess profits tax

Without regard to section 736 (a)

13. Excess profits net income (installment basis)		$750,000
14. Less: Excess profits credit	$289,750	
15. Specific exemption	5,000	
		294,750
16. Adjusted excess profits net income		455,250
17. Excess profits tax (90 percent)		409,725

(Pursuant to election under section 736 (a)

18. Excess profits net income (accrual basis)		440,000
19. Less: Excess profits credit	$289,750	
20. Specific exemption	5,000	
		294,750
21. Adjusted excess profits net income		145,250
22. Excess profits tax (90 percent)		130,725
23. Corporation surtax net income (accrual basis (item 18))		440,000
24. 80 percent of item 23		352,000
25. Less income tax under Chapter 1 (item 12)		241,900
26. Item 24 less item 25		110,100
27. Excess profits tax (item 22 or item 26, whichever is the lesser)		110,100

Tax computed without regard to section 736 (a):	
Income tax	117,900
Excess profits tax	409,725
Total	527,625
Tax computed pursuant to election under section 736 (a):	
Income tax	241,900
Excess profits tax	110,100
Total	352,000
Tax saving resulting from election under section 736 (a)	175,625

§ 35.736 (a)–4 *Election to abandon straight accrual basis and to return to installment basis.* If the taxpayer establishes for any excess profits tax taxable year subsequent to the year in which it elected under the provisions of section 736 (a) and § 35.736 (a)–2 to compute for excess profits tax purposes income from installment sales on the straight accrual basis that:

(a) Such election was based upon a comparison of the average volume of credit extended to purchasers on the installment plan in the installment base period with the volume of credit for such year, and that such average volume of credit extended in the installment base period is not more than 125 percent of the volume of credit extended to purchasers on the installment plan in the taxable year, or

(b) Such election was based upon a comparison of the average outstanding accounts receivable for the installment base period with the amount of such accounts receivable at the end of such year, and that such average outstanding accounts receivable for the installment base period is not more than 125 percent of the amount of such accounts receivable at the end of the taxable year,

the taxpayer may elect in its excess profits tax return for the taxable year to abandon for excess profits tax purposes the computation of income from installment sales on the straight accrual basis and may elect under the method provided by section 44(a) to compute its income from installment sales as that proportion of installment payments actually received in the taxable year which the gross profit realized or to be realized when payment is completed, bears to the total contract price. When made, such election shall be irrevocable and shall be applicable not only to the taxable year for which the election is made but also to all subsequent excess profits tax taxable years. No such election may be made if subsequent to the year for which the taxpayer has elected under section 736(a) and § 35.736(a)–2 to compute its income from installment sales on the straight accrual basis, the taxpayer has received permission from the Commissioner under section 41 and the regulations thereunder to change its accounting method for purposes of the income tax under Chapter 1 to the straight accrual basis. An election made under section 736(a) and this section to abandon the straight accrual basis and to resume the installment basis method provided by section 44(a) precludes any further election under section 736 (a) and § 35.736 (a)–2, and no future election can be made to compute, for excess profits tax purposes, income from installment sales on the straight accrual basis. An election made by the taxpayer pursuant to the provisions of § 30.736 (a)–4 of this chapter shall be deemed to be made pursuant to the provisions of this section.

If the election under section 736(a) and this section is made to resume the installment method of computing income from installment sales, the income from such sales computed upon such basis shall be included in excess profits net income for the taxable year for which the election is made and for all subsequent excess profits tax taxable years. Such income shall be computed in accordance with section 44(c), and amounts received during any such year on account of sales or other disposition of property made in any prior year (whether the income for such prior year was computed on the installment or the straight accrual basis) shall not be excluded in the computation of excess profits net income.

In computing the net operating loss deduction pursuant to section 23(s), section 122, and section 711(a)(1)(J) or section 711(a)(2)(L) for the purposes of the excess profits tax for a taxable year for which income from installment sales is computed under the method provided by section 44(a) pursuant to an election under section 736(a) and this section to abandon the straight accrual basis:

(a) The net operating loss under section 122(a) and the net income under section 122(b) for any prior taxable year shall be determined by computing income from installment sales upon the basis, straight accrual basis or installment basis provided by section 44(a), used in computing excess profits net income for such year,

(b) The net operating loss for any subsequent taxable year shall be determined by computing income from installment sales upon the installment basis method provided in section 44(a),

(c) The excess profits net income for the taxable year for which the net operating loss deduction is computed shall, for the purposes of the reduction provided by section 711(a)(1)(J)(ii) or section 711(a)(2)(L)(ii), be determined by computing income from installment sales under the installment basis method provided by section 44(a).

The unused excess profits credit under section 710 (c) (2) for any prior excess profits tax taxable year and the adjusted excess profits net income for any such year (used in the computation of the unused excess profits credit carry-over) shall be determined upon the basis of the excess profits net income for such year which shall include income from installment sales computed upon the basis, straight accrual basis or installment basis provided by section 44 (a), used in computing excess profits net income for such year. The unused excess profits credit for a subsequent excess profits tax taxable year shall be determined upon the basis of the excess profits net income which shall include income from installment sales computed upon the installment method provided by section 44 (a). The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits credit carrybacks to such year. For the computation of the unused excess profits credit adjustment, see section 710 (c) and § 35.710–4.

With respect to those excess profits tax taxable years for which the taxpayer has resumed the computation of income from installment sales on the installment basis provided by section 44 (a), normal tax net income and corporation surtax net income for the purposes of computing the excess profits tax shall prior to any adjustments under section 711 (a) and section 710 (a) (1) (B), be the normal tax net income and the corporation surtax net income used in the computation of the normal tax and the surtax under Chapter 1.

[SEC. 736. RELIEF FOR INSTALLMENT BASIS TAXPAYERS AND TAXPAYERS WITH INCOME FROM LONG-TERM CONTRACTS. (Added by sec. 222 (d), Rev. Act 1942.)]

* * * * *

(b) *Election on long-term contracts.* In the case of any taxpayer computing income from contracts the performance of which requires more than 12 months, if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, it may elect, in its return for such taxable year for the purposes of this subchapter, or in the case of a taxable year the return for which was filed prior to the date of the enactment of the Revenue Act of 1942, within 6 months after the date of the enactment of such Act, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, such income upon the percentage of completion method of accounting. Such election shall be made in accordance with such regulations and shall be irrevocable when once made and shall apply to all other contracts, past, present, or future, the performance of which required or requires more than 12 months. The net income of the taxpayer for each year prior to that with respect to which the election is made shall be adjusted for the purposes of this subchapter, including the computation of excess profits net income in each taxable year of the base period under section 711 (b), to conform to such election but for purposes of chapter 1, the tax imposed by this subchapter for any prior taxable year on account of the adjustment required by this subsection shall be considered a part of the tax imposed by this subchapter for the taxable year in which such income is, without regard to this subsection, includible in gross income. Income described in this subsection shall not be considered abnormal income under section 721.

§ 35.736 (b)–1 *Taxpayers with income from long-term contracts; eligibility for relief.* Section 736 (b) provides relief with respect to a taxpayer which computes, pursuant to section 42 and § 29.42–4 (b) of this chapter (or the corresponding provision of prior regulations), income from contracts the performance of which requires more than 12 months (hereinafter called "long-term contracts") for the taxable year in which such contracts are finally completed and accepted (hereinafter called the "completed contract basis"), if such taxpayer establishes that either:

(a) It is abnormal for the taxpayer to derive income from such class of long-term contracts, or

(b) The taxpayer normally derives income from such class of long-term contracts, but the amount of such income of such class includible in the gross income of the taxpayer for th taxable year is in excess of 125 percent of the average amount of the gross income of the same class for the four previous taxable years, or if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence (hereinafter called the "long-term contract base period"). In determining whether performance required a period of more than 12 months, only the period beginning with the commencement of the work and ending with its completion shall be taken into account. If 12 months or less elapse between the beginning of the work and its completion, the contract is not a long-term contract even though more than 12 months may have elapsed between the execution of such contract and the completion of its performance.

The average amount of gross income from long-term contracts in the long-term contract base period of a taxpayer shall be the aggregate of the gross incomes from such long-term contracts for each year in such base period divided by the number of months in such period and multiplied by 12. If the taxable year for which the election under section 736 (b) and § 35.736 (b)–2 is made is a year of less than 12 months, the number of months in such year shall be used for the purposes of the preceding sentence instead of 12. For the definition of gross income see section 22 (a).

§ 35.736 (b)–2 *Election to report income upon percentage of completion basis.* If the taxpayer satisfies the eligibility requirements provided in section 736 (b) and § 35.736 (b)–1 with respect to a taxable year beginning after December 31, 1939, it may elect in its excess profits tax return for such year, or if the election is made for a taxable year the excess profits tax return for which was filed prior to October 21, 1942 (the date of enactment of the Revenue Act of 1942), it may elect not later than April 21, 1943 (six months after the date of enactment of the Revenue Act of 1942), to compute its income from long-term contracts upon the percentage of completion method of accounting under the provisions of § 29.42–4 (a) of this chapter or § 19.42–4 (a) of Regulations 103 applicable to the taxable year for which the tax is being computed. An election made by the taxpayer pursuant to the provisions of § 30.736 (b) (2) of this chapter shall be deemed to be made pursuant to the provisions of this section.

If the election to compute income from long-term contracts upon the percentage of completion method of accounting is made in an excess profits tax return filed on or after October 21, 1942, the taxpayer shall file with its return for such year the following:

(a) A schedule setting forth in columnar form a comparison between the gross income from long-term contracts reported in the long-term contract base period and the gross income from long-term contracts which would be reported upon the completed contract basis for the taxable year, together with a statement of the percentage which the latter bears to the average of the former.

(b) A schedule showing the recomputation of the average base period net income and the excess profits net income for each year in the base period with income from long-term contracts computed upon the percentage of completion method of accounting. Included in this schedule shall be an analysis of all long-term contracts entered into, the income from which has been reported in income tax returns for the purposes of Chapter 1 for the taxable years beginning with the first taxable year in the base period of the taxpayer and ending with the taxable year for which the election is made, and including all long-term contracts which in such year of election are in the process of completion. The schedule shall contain a statement of the percentage of completion of such contracts for all such years supported, if possible, by architect's certificates or, if such certificates are not obtainable for such prior years, by other competent evidence establishing the percentage of completion claimed for such years.

(c) Amended excess profits tax returns for each prior excess profits tax taxable year for which a recomputation is necessitated by reason of the election to recompute income from long-term contracts upon the percentage of completion method of accounting, and amended income tax returns if necessary to reflect the recomputation of excess profits tax for such prior year. If the recomputation has produced an overassessment for any of such years, the taxpayer should file a claim for refund on Form 843 with the amended returns for such years.

If the taxpayer desires to make the election under section 736 (b) for an excess profits tax taxable year, the return for which was filed prior to October 21, 1942, such election shall be made by the taxpayer filing an amended excess

profits tax return for such year and an amended income tax return for such year, if necessary to reflect the recomputation of the excess profits tax for the year, on or before April 21, 1943. The additional information set forth in the preceding paragraph shall also be filed with such returns.

If the taxpayer elects under the provisions of section 736 (b) and this section to compute its excess profits net income from long-term contracts upon the percentage of completion method of accounting, such election shall be irrevocable when once made. The election shall apply to all other long-term contracts entered into by the taxpayer, whether completed in the past, or in the taxable year, or whether such contracts are partly performed and are to be completed in the future, and to contracts which may be entered into in the future as well as to contracts which have already been entered into by the taxpayer. The income for excess profits tax purposes for each taxable year prior to the year in which the election is made to compute excess profits net income from long-term contracts upon the percentage of completion method of accounting shall be adjusted to conform to such method. The excess profits net income under section 711 (b) for each taxable year in the base period, for the purposes of computing the average base period net income under section 713 or section 742, shall also be adjusted so as to conform to such election and the income from long-term contracts shall be computed upon the percentage of completion method of accounting. If the taxpayer uses the excess profits credit based upon invested capital pursuant to section 714, the determination of accumulated earnings and profits shall be made without regard to any adjustment resulting from any election made under section 736 (b) or this section, except as such election is reflected in the amount of income tax or excess profits tax payable for taxable years beginning after December 31, 1939.

The election made pursuant to section 736 (b) and this section to compute income from long-term contracts upon the percentage of completion method of accounting shall apply only with respect to average base period net income and to excess profits net income for an excess profits tax taxable year. For purposes of the income tax under Chapter 1, or the surtax on personal holding companies or the declared value excess profits tax under Chapter 2, income from such contracts shall be computed upon the completed contract basis.

If the taxpayer does not satisfy the eligibility requirements of section 736 (b) and § 35.736 (b)–1 for a taxable year beginning prior to January 1, 1943, it is not precluded from electing for any subsequent excess profits tax taxable year with respect to which it satisfies such eligibility requirements to compute its income from long-term contracts on the percentage of completion basis for the purposes of the excess profits tax. Moreover, the taxpayer need not elect under section 736 (b) and this section to compute income from long-term contracts on the percentage of completion basis for the first excess profits tax taxable year with respect to which the eligibility requirements are satisfied. Failure so to elect does not preclude an election for a subsequent excess profits tax taxable year with respect to which the eligibility requirements are met.

§ 35.736 (b)–3 *Computation of net income upon percentage of completion method of accounting*—(a) *Excess profits tax taxable year.* If a taxpayer has elected under section 736 (b) and § 35.736 (b)–2 to compute for excess profits tax purposes its net income from long-term contracts upon the percentage of completion method of accounting, in lieu of the completed contract basis, gross income from such long-term contracts shall be reported for each excess profits tax taxable year upon the basis of percentage of completion of such contract in such year. There shall be deducted from such gross income for a taxable year all expenditures made during such year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable year for use in connection with the work under the contract but not yet so applied. Any deductions under section 23 which are limited to a percentage of net income (computed without regard to such deduction, as for example, the deduction for charitable contributions which is allowed by section 23 (q)) shall, for excess profits tax purposes, be determined upon the basis of such net income with the income from long-term contracts computed upon the percentage of completion method of accounting, and not upon the basis of net income for Chapter 1 purposes. No reserve for bad debts arising from accounts receivable from long-term contracts may be set up for excess profits tax purposes unless a reserve has been established for income tax purposes.

In computing the net operating loss deduction for the purposes of the excess profits tax for a taxable year pursuant to section 23 (s), section 122, and section 711 (a) (1) (J) or section 711 (a) (2) (L), the net operating loss under section 122 (a) and the net income under section 122 (b) for any taxable year prior or subsequent to the taxable year in which the election under section 736 (b) and § 35.736 (b)–2 is made shall be determined by computing income from long-term contracts upon the percentage of completion method of accounting. The excess profits net income for the taxable year for which the net operating loss deduction is computed shall, for the purposes of the reduction provided by section 711 (a) (1) (J) (ii) or section 711 (a) (2) (L) (ii), be determined by computing income from long-term contracts upon the percentage of completion method of accounting.

In computing normal tax net income for the purposes of determining excess profits net income, the credit for dividends received shall be limited to 85 percent of the adjusted net income computed by determining income from long-term contracts upon the percentage of completion method of accounting as provided in section 736 (b) and this section instead of upon the completed contract basis.

The excess profits tax may be computed under section 710 (a) (1) (B) as an amount which when added to the normal tax and surtax computed under Chapter 1 equals 80 percent of the corporation surtax net income computed without regard to the credit under section 26 (e) (relating to income subject to excess profits tax). For such purpose, the corporation surtax net income shall be determined by computing the income from long-term contracts upon the percentage of completion method of accounting. The credit for dividends received used in computing corporation surtax net income shall be limited to 85 percent of the net income determined by computing income from long-term contracts upon the percentage of completion method of accounting, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1.

The unused excess profits credit under section 710 (c) (2) for any excess profits tax taxable year for which the excess profits net income is determined by computing income from long-term contracts upon the percentage of completion method of accounting pursuant to the election exercised under section 736 (b) and § 35.736(b)–2 shall be computed with regard to the excess profits net income so computed. The adjusted excess profits net income used in the computation of the unused excess profits credit carry-back and carry-over under section 710 (c) (3) shall be the adjusted excess profits net income determined by computing income from long-term contracts upon the percentage of completion method of accounting as described in this section. The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits credit carry-backs to such taxable year, and shall be applied against excess profits net income for such year determined by computing income from long-term contracts upon the percentage of completion method of accounting. However, no unused excess profits credit carry-back may be used against excess profits net income for an excess profits tax taxable year beginning prior to January 1, 1941, regardless of the fact that the excess profits net income for such year has been increased by income from long-term contracts computed upon the percentage of completion method of accounting, whereas if such income had been computed upon the completed contract basis it would be attributable to a subsequent taxable year to which an unused excess profits credit carry-back would be allowed. For the computation of the unused excess profits credit adjustment, see section 710 (c) and § 35.710–4.

The excess profits tax for a taxable year recomputed as provided in this section shall be the excess profits tax for such year for the purposes of the provisions of Supplement L of Chapter 1, relating to assessment and collection of deficiency, the provisions of Supplement M of Chapter 1, relating to interest and additions to tax, and the provisions of Supplement O of Chapter 1, relating to overpayments. Any amount of excess profits tax deferred under section 710 (a)

(5) on account of relief claimed under section 722, any amount of foreign tax credit under section 729 (c) and (d) which is limited to a portion of the excess profits tax imposed, any credit for debt retirement under section 783, and any amount of post-war refund under section 780 shall be computed with respect to the excess profits tax so determined.

In no event shall income from long-term contracts computed for excess profits tax purposes upon the percentage of completion method of accounting pursuant to an election under section 736 (b) and § 35.736 (b)–2 be considered abnormal income under section 721.

(b) *Taxable year in the base period.* If a taxpayer elects, pursuant to section 736 (b) and § 35.736 (b)–2, to compute its income from long-term contracts upon the percentage of completion method of accounting, the excess profits net income for a taxable year in the base period to be used in computing the average base period net income shall be computed pursuant to section 711 (b) but with income from long-term contracts computed upon the percentage of completion method of accounting as described in § 35.736 (b)–3 in lieu of the completed contract basis method. In such event gross income attributable to each long-term contract shall be placed in the appropriate year in the base period upon the percentage of completion method of accounting, regardless of whether such contract was completed in a subsequent year in the base period or in an excess profits tax taxable year and regardless of when gross income from such contract was reported for income tax purposes under Chapter 1. Likewise, gross income attributable to each long-term contract completed during a taxable year in the base period shall be included in income for such year only to the extent to which such income is attributable to the percentage of the contract completed in such year. Gross income attributable to the percentage of the contract completed prior to the base period shall be excluded in the computation of excess profits net income for a taxable year in the base period and consequently from average base period net income. There shall be deducted from such gross income for each taxable year in the base period all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of each year for use in connection with the work under the contract but not yet so applied.

(c) *Adjustment of income tax liability.* For purposes of the normal tax and surtax and of the surtax on corporations improperly accumulating surplus imposed by Chapter 1, the excess profits tax imposed by Subchapter E of Chapter 2 for any taxable year on account of the adjustment in excess profits tax for such year required by the recomputation of income from long-term contracts upon the percentage of completion method of accounting pursuant to the election under section 736(b), shall be considered a part of the excess profits tax imposed by Subchapter E of Chapter 2 for the taxable year in which such income is, without regard to the provisions of section 736(b), includible in gross income.

The excess profits tax imposed by Subchapter E of Chapter 2 for any excess profits tax taxable year on account of the recomputation of income from long-term contracts required by section 736(b) shall be the amount by which the excess profits tax imposed for such year with the income from long-term contracts computed upon the percentage of completion method of accounting exceeds the excess profits tax imposed for such year computed upon the completed contract basis method of accounting. The amount of such increase in excess profits tax which is attributable to the inclusion in excess profits net income for such year of income from long-term contracts computed upon the percentage of completion method of accounting shall be added to the excess profits tax imposed for the year in which the income from such long-term contracts would be includible in gross income under the completed contract basis method of accounting. The amount of such increase shall be the increase prior to the inclusion in the excess profits tax for the taxable year in which the increase is determined of any increase in a prior taxable year attributable to a contract the gross income from which would be reported upon the completed contract basis for the year for which the increase is determined. If an increase in excess profits tax for a taxable year is due to income attributable to two or more contracts which are not completed in such year but the income from which is included in excess profits net income for such year upon the percentage of completion method of accounting, the portion of such increase attributable to each contract shall be the same proportion of the total increase for such year which the income attributable to such contract for such year is of the total income from such contracts for such year. The amount of income computed upon the percentage of completion method of accounting which is attributable to a contract in any taxable year shall be the gross income (so computed) minus the direct cost for such year on account of such contract, but shall not include any deductions, expenses, or costs which are not directly charged to such contract under the method of cost accounting employed by the taxpayer. The increase in excess profits tax so attributed to each contract shall be considered to be a part of the excess profits tax for the taxable year in which such contract is completed and in which the income would be reported under the completed contract basis method of accounting.

For the purposes of the credit under section 26 (e) for income subject to excess profits tax, the excess profits tax for any taxable year for which an increase in tax is considered to be part of the tax for a subsequent taxable year shall be deemed to be the excess profits tax computed for such year upon the completed contract basis method of accounting, increased by any increase in excess profits tax for a prior taxable year due to income from long-term contracts being computed upon the percentage of completion method of accounting if the income from such contracts would have been reported for the taxable year upon the completed contract basis.

If the excess profits tax imposed for an excess profits tax taxable year recomputed pursuant to the election under section 736 (b) is less than the excess profits tax imposed for such prior year computed without regard to the election under section 736 (b), there is no amount of excess profits tax attributable to any contract which is to be completed in a future year and the income from which, computed upon the completed contract basis, would be included in gross income for such future year. Consequently no adjustment in the excess profits tax for such future year is to be made. With respect to the taxable year for which the excess profits tax recomputed pursuant to the election under section 736 (b) is less than the excess profits tax computed without regard to such election, the excess profits tax for the purposes of Chapter 1 shall be the excess profits tax computed pursuant to the election under section 736 (b) increased by any increase in excess profits tax for a prior taxable year due to income from long-term contracts being computed upon the percentage of completion method of accounting if the income from such contracts would have been reported for the taxable year upon the completed contract basis.

The excess profits tax imposed by Subchapter E of Chapter 2 for any taxable year shall be the tax prior to the tax deferment under section 710(a)(5), prior to the credit for foreign taxes under section 729(c) and (d), prior to the credit for debt retirement under section 783, and prior to the adjustment under section 734 in case of position inconsistent with prior income tax liability. The recomputation pursuant to the election under section 736(b) of excess profits tax imposed for any taxable year involves not only a recomputation of the excess profits net income for such taxable year by placing income from long-term contracts upon the percentage of completion method of accounting, but also a recomputation of the average base period net income upon such accounting method, if the excess profits credit based on income pursuant to section 713 is used.

If income from long-term contracts is computed upon the percentage of completion method of accounting pursuant to the election under section 736(b), the following rules are applicable in determining, for the purposes of Chapter 1, the excess profits tax, and the method of utilizing such tax, for a taxable year in which income from such contracts would be reported upon the completed contract basis:

(1) There is allowed as a credit by section 26(e) in computing normal tax net income and surtax net income, the amount of income subject to excess profits tax. If the excess profits tax is computed pursuant to an election under section 736(b), such income is the amount of which the excess profits tax computed under section 710(a)(1)(A) is 90 percent. For purposes of the credit provided by section 26(e), the amount of excess profits tax so computed is considered to include the increase in excess profits tax imposed for a year beginning

prior to January 1, 1942, and attributable to a contract which is completed, and the income from which would be reported on the completed contract basis, in a taxable year beginning after December 31, 1941. Consequently, the excess profits tax for a year beginning in 1942 would be deemed to include any increase in excess profits tax for a taxable year beginning in 1940 or 1941 and attributable to a contract ending in 1942.

(2) In the case of the surtax on corporations improperly accumulating surplus, the credit under section 26(e) for income subject to excess profits tax shall be deducted in determining section 102 net income for such year pursuant to section 102(d)(1)(D).

For rules applicable to taxable years beginning in 1940 and 1941 where an election is made under section 736(b) and § 35.736(b)–2 for an excess profits tax taxable year beginning after December 31, 1941, or for a subsequent taxable year, to compute income from long-term contracts upon the percentage of completion method of accounting, see § 30.736(b)–3 of this chapter.

The income tax for a taxable year recomputed as provided in this section shall be the income tax for such year for the purposes of the provisions of Supplement L of Chapter 1, relating to assessment and collection of deficiency, the provision of Supplement M of Chapter 1, relating to interest and additions to tax, and the provisions of Supplement O of Chapter 1, relating to overpayments. Any amount of foreign tax credit under section 131 which is limited to a portion of the income tax imposed shall be computed with respect to the income tax so determined.

The provisions of this section may be illustrated by the following example:

Example. Corporation C, which came into existence early in 1935, is a contractor deriving all its income from the performance of long-term contracts requiring more than 12 months to complete. It computes its income for income tax purposes on the calendar year basis under the provisions of section 42 and § 29.42–4 (b) of this chapter, or § 19.42–4 (b) of Regulations 103. It has established that gross income from long-term contracts completed in 1942 is in excess of 125 percent of the average amount of gross income from such contracts in 1938, 1939, 1940, and 1941. It therefore elects under section 736 (b) and § 35.736 (b)–2 to compute its income from long-term contracts upon the percentage of completion method of accounting. Income from such contracts must be computed upon the percentage of completion method of accounting for the excess profits tax taxable years 1940, 1941, 1942, and subsequent years and also for the base period years 1936, 1937, 1938, and 1939. The net income of Corporation C from long-term contracts computed upon the percentage of completion method of accounting and upon the completed contract basis method of accounting, and the deductions (not including any deduction based upon excess profits tax) are shown in the following schedule:

	1935	1936	1937	1938	1939	1940	1941	1942
Income from contracts upon completed contract basis (gross income minus expenditures)	----	$50,000	$150,000	----	$110,000	$200,000	$220,000	$250,000
Other deductions (not including excess profits tax or credit for income subject to excess profits tax)	$7,000	8,000	8,000	$10,000	11,000	12,000	15,000	11,000
Net income upon completed contract basis	(7,000)	42,000	142,000	(10,000)	99,000	188,000	205,000	239,000
Income from contracts upon percentage of completion method (gross income minus expenditures):								
Contract A	30,000	20,000	----	----	----	----	----	----
Contract B	40,000	60,000	50,000	----	----	----	----	----
Contract C	----	----	30,000	40,000	40,000	----	----	----
Contract D	----	----	----	70,000	80,000	50,000	----	----
Contract E	----	----	----	----	10,000	90,000	40,000	----
Contract F	----	----	----	----	----	25,000	55,000	----
Contract G	----	----	----	----	----	----	150,000	100,000
Contract H [1]	----	----	----	----	----	----	70,000	50,000
Total	70,000	80,000	80,000	110,000	130,000	165,000	315,000	150,000
Other deductions (not including excess profits tax or credit for income subject to excess profits tax)	7,000	8,000	8,000	10,000	11,000	12,000	15,000	11,000
Net income upon percentage of completion method	63,000	72,000	72,000	100,000	119,000	153,000	300,000	139,000

[1] Incomplete December 31, 1942.

Assume, for the purpose of computing tax for 1942, that except for the credit for income subject to excess profits tax, there are no adjustments to net income shown in the preceding schedule in computing normal tax net income, corporation surtax net income, or excess profits net income, and that dividends out of earnings and profits were distributed for each year in the base period equal to the amount of the net income computed upon the completed contract basis for such year. The average base period net income computed upon the completed contract basis is determined under section 713 (d) and (e), since the income for the last half of the base period does not exceed the income for the first half. The average base period net income upon which is based the excess profits credit based on income for 1942 is $88,437.50, i. e., the aggregate of the incomes for 1936, 1937, and 1939 plus $70,750, assumed to be the excess profits net income for 1938 under section 713 (e) (1) (75 percent of the average of the incomes for 1936, 1937, and 1939) divided by 4. The excess profits credit based on income for 1942 is $84,015.63 (95 percent of $88,437.50). The average base period net income computed upon the percentage of completion method of accounting is determined under section 713 (d) and (f), since the income for the last half of the base period exceeds the income for the first half. The average base period net income for 1942 is $119,000, i. e., one-half of the sum of $100,000 (the income for 1938, $119,000 (the income for 1939), and $37,500 (one-half of the amount by which the aggregate of the incomes for 1938 and 1939 exceeds the aggregate of the incomes for 1936 and 1937) but not in excess of $119,000. The excess profits credit based on income for such year is $113,050 (95 percent of $119,000). The income and excess profits tax computed for 1942 without regard to section 736 (b) and pursuant to an election under section 736 (b) is as follows:

Income tax

Without regard to section 736(b)

1. Net income (completed contract basis)		$239,000.00
2. Less credit under section 26(e) for income subject to excess profits tax (item 12)		149,984.37
3. Normal tax net income and corporation surtax net income		89,015.63
4. Normal tax and surtax (40 percent)		35,606.25

Pursuant to election under section 736 (b)

5. Net income (completed contract basis)		$239,000.00
6. Less credit under section 26(e) for income subject to excess profits tax (item 20)		39,572.16
7. Normal tax net income and corporation surtax net income		199,427.84
8. Normal tax and surtax (40 percent)		79,771.14

Excess profits tax

Without regard to section 736(b)

9. Excess profits net income (completed contract basis)		$239,000.00
10. Less: Excess profits credit	$84,015.63	
11. Specific exemption	5,000.00	
		89,015.63
12. Adjusted excess profits net income		149,984.37
13. Excess profits tax (90 percent)		134,985.93

Pursuant to election under section 736(b)

14. Excess profits net income (percentage of completion method)		$139,000.00
15. Less: Excess profits credit	$113,050	
16. Specific exemption	5,000	
		118,050.00
17. Adjusted excess profits net income		20,950.00

Excess profits tax—Continued

18. Excess profits tax (90 percent)		$18,855.00
19. Excess profits tax upon which is based credit under section 26(e) for 1942 income tax purposes (item 18 plus $16,759.94, portion of increase in 1941 excess profits tax attributable to contract G completed in 1942 [1])		35,614.94
20. Credit under section 26(e) for income subject to excess profits tax for 1942 income tax purposes (amount of which $35,614.94 (item 19) is 90 percent)		39,572.16
Without regard to section 736(b)		
(i) Excess profits net income (completed contract basis)		$205,000.00
(ii) Less: Excess profits credit	$67,212.50	
(iii) Specific exemption	5,000.00	
		72,212.50
(iv) Adjusted excess profits net income		132,787.50
(v) Excess profits tax ($41,500 plus 50 percent of $32,787.50)		57,893.75
Pursuant to election under section 736(b)		
(vi) Excess profits net income (percentage of completion method)		$300,000.00
(vii) Less: Excess profits credit	$113,050	
(viii) Specific exemption	5,000	
		118,050.00
(ix) Adjusted excess profits net income		181,950.00
(x) Excess profits tax ($41,500 plus 50 percent of $81,950)		82,475.00
(xi) Increase in excess profits tax due to election under section 736(b) (item (x) minus item (v))		24,581.25
(xii) Portion of increase attributable to contract G completed in 1942 $\left(\frac{150,000}{220,000}\text{ of }\$24,581.25\right)$		16,759.94
Tax computed without regard to section 736 (b):		
Income tax		35,606.25
Excess profits tax		134,985.93
Total		170,592.18
Tax computed pursuant to election under section 736 (b):		
Income tax		79,771.14
Excess profits tax		18,855.00
Total		98,626.14
Tax saving resulting from election under section 736 (b)		71,966.04

[1] This amount is derived from the following computations of excess profits tax for 1941 under the law applicable to 1941. For complete computations of the income and excess profits taxes for 1940 and 1941 both without regard to section 736(b) and pursuant to election under section 736(b), in the case of the above example, see the example in § 30.736(b)–3(c) of this chapter.

[SEC. 736. RELIEF FOR INSTALLMENT BASIS TAXPAYERS AND TAXPAYERS WITH INCOME FROM LONG-TERM CONTRACTS. (Added by sec. 222 (d), Rev. Act 1942.)]

* * * * *

(c) *Adjustment on account of change.* If an adjustment specified in subsection (a) or subsection (b), as the case may be, is, with respect to any taxable year, prevented, on the date of the election by the taxpayer under subsection (a) or subsection (b), as the case may be, or within two years from such date, by any provision or rule of law (other than this section and other than section 3761, relating to compromises), such adjustment shall nevertheless be made if in respect of the taxable year for which adjustment is sought a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within two years after the date such election is made. If at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then the amount of the adjustment authorized by this subsection shall be limited to the increase or decrease in the tax imposed by Chapter 1 and this subchapter previously determined for such taxable year which results solely from the effect of subsection (a), or subsection (b), as the case may be, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such election, two years remain before the expiration of the period of limitation upon assessment or the filing of claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 734 (d). The amount to be assessed and collected under this subsection in the same manner as if it were a deficiency or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain or loss, other than one resulting from the effect of subsection (a) or subsection (b), as the case may be. Such amount, if paid, shall not be recovered by a claim or suit for refund, or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain or loss, other than one resulting from the effect of subsection (a) or subsection (b), as the case may be.

§ 35.736 (c)–1 *Adjustment on account of changes arising from election under section 736 (a) or section 736 (b).* The recomputation of the tax liability authorized by section 736 (c) applies to the income tax and to the surtax on corporations improperly accumulating surplus, imposed by Chapter 1, and to the excess profits tax imposed by Subchapter E of Chapter 2. Under section 736 (c), if the adjustment of any such taxes imposed for any taxable year, to give effect to the recomputations provided under section 736 (a) (in the case of an installment basis taxpayer) or under section 736 (b) (in the case of a taxpayer with long-term contracts), is prevented on the date of the election by the taxpayer under section 736 (a) or section 736 (b), as the case may be, or within two years from such date by any provision of law (other than section 736 and other than section 3761, relating to compromises) or by any rule of law, including the doctrine of res adjudicata, an adjustment shall nevertheless be made if with respect to the taxable year for which such adjustment is sought a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within two years after the date such election was made. Section 736 (c) applies only if at the time of filing of a claim for refund or the mailing of the notice of the deficiency the adjustment would otherwise be prevented by the running of the statute of limitations, by the execution of a closing agreement, by the operation of the rule of res adjudicata, or because of other reasons. For reference to provisions which would prevent adjustment except for the provisions of section 736 (c), see § 29.3801 (b)–0 of this chapter. Section 736 (c) is not applicable if, on the date of the filing of the claim for refund or the mailing of the notice of deficiency, adjustment of the tax liability is permissible without recourse to such section.

The amount of the adjustment authorized by section 736 is limited to the increase or decrease in the tax imposed by Chapter 1 or the tax imposed by Subchapter E of Chapter 2 previously determined for the taxable year which results solely from the revision of the excess profits tax liability effectuated by section 736 (a) or section 736 (b), as the case may be, and the collateral effects of such revision upon items of income, deductions, credits, average base period net income, etc., already taken into account in ascertaining the tax previously determined. The tax previously determined shall be ascertained in accordance with section 734 (d). See § 35.734–4. If the amount of the adjustment determined under section 736 (c) represents an increase in tax, it is to be treated in the same maner, and assessed and collected as if it were a deficiency for the taxable year; if the amount of the adjustment represents a decrease in tax, it is to be treated, credited, or refunded, in the same manner as if it were an overpayment for the taxable year. In either case the increase or decrease shall be treated as if on the date of the election pursuant to section 736 (a) or section 736 (b), as the case may be, two years

remain before the expiration of the period of limitation upon assessment or the filing of a claim for refund for the taxable year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year for which the adjustment is made.

The amount of any adjustment under section 736 (c) to be collected in the same maner as if it were a deficiency and the amount of any adjustment to be refunded or credited in the same manner as if it were an overpayment, as the case may be, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption or gain or loss other than one resulting from the effect of section 736 (a) or section 736 (b), as the case may be.

The amount of any adjustment under the provisions of section 736 (c) which is refunded may not subsequently be recovered in a suit for erroneous refund based upon any adjustment other than one resulting from the revision of excess profits tax liability occasioned by the recomputation of tax pursuant to an election under section 736 (a) or section 736 (b), as the case may be. The amount of any adjustment under section 736 (c) which is assessed and collected as a deficiency may not thereafter be recovered by the taxpayer in any suit for refund based upon any adjustment other than one resulting from the revision of excess profits tax liability occasioned by the recomputation of tax pursuant to an election under section 736 (a) or section 736 (b), as the case may be.

Rules in Connection With Certain Exchanges [1]

Excess Profits Credit Based on Income [2]

Sec. 745. Definitions. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 8 (a), (b), and (c), Excess Profits Tax Amendments 1941, and by sec. 228 (a), Rev. Act 1942.]

For the purposes of this Supplement—

(a) *Acquiring corporation.* The term "acquiring corporation" means—

(1) A corporation which has acquired—

(A) substantially all the properties of another corporation and the whole or a part of the consideration for the transfer of such properties is the transfer to such other corporation of all the stock of all classes (except qualifying shares) of the corporation which has acquired such properties, or

(B) substantially all the properties of another corporation and the sole consideration for the transfer of such properties is the transfer to such other corporation of voting stock of the corporation which has acquired such properties, or

(C) before October 1, 1940, properties of another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock owned by such other corporation, or

(D) substantially all the properties of a partnership in an exchange to which section 112 (b) (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5), or to which a corresponding provision of a prior revenue law, is or was applicable.

For the purposes of subparagraphs (B) and (C) in determining whether such voting stock or such paid-in surplus or contribution to capital is the sole consideration, the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded. Subparagraph (B) or (C) shall apply only if the corporation transferring such properties is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has the effect of a statutory merger or consolidation.

(2) A corporation which has acquired property from another corporation in a transaction with respect to which gain or loss was not recognized under section 112 (b) (6) of Chapter 1 or a corresponding provision of a prior revenue law;

(3) A corporation the result of a statutory merger of two or more corporations; or

(4) A corporation the result of a statutory consolidation of two or more corporations.

(b) *Component corporation.* The term "component corporation" means—

(1) In the case of a transaction described in subsection (a) (1), the corporation which transferred the assets;

(2) In the case of a transaction described in subsection (a) (2), the corporation the property of which was acquired;

(3) In the case of a statutory merger, all corporations merged, except the corporation resulting from the merger; or

(4) In the case of a statutory consolidation, all corporations consolidated, except the corporation resulting from the consolidation; or

(5) In the case of a transaction specified in subsection (a) (1) (D), the partnership whose properties were acquired.

(c) *Income of certain component corporations not included.* For the purposes of section 712, section 742, and section 743 in the case of a corporation which is a component corporation in a transaction described in subsection (a)—

(1) Except as provided in paragraph (2), for the purpose of computing, for any taxable year beginning after December 31, 1941, the excess profits credit of such component corporation or of an acquiring corporation of which the acquiring corporation in such transaction is not a component, except in the application of sections 713 (f) and 742 (h) (other than the limitation on the amount of average base period net income or Supplement A average base period net income, as the case may be, determined thereunder), no account shall be taken of the excess profits net income of such component corporation for any period before the day after such transaction, or of the excess profits net income for any period before the day after such transaction of its component corporations in any transaction before such transaction, and no account shall be taken of the capital addition or capital reduction of such component corporation either immediately before such transaction or for any prior period, or of the capital addition or capital reduction either immediately before such transaction or for any prior period of its component corporations in any transaction before such transaction.

(2) In case such transaction occurred in a taxable year of such component corporation beginning after December 31, 1941, for the purpose of computing the excess profits credit of such component corporation for such taxable year, the amount of its average base period net income or Supplement A average base period net income, as the case may be, shall be limited to an amount which bears the same ratio to such average base period net income or Supplement A average base period net income, as the case may be (computed without regard to this paragraph but with the application of paragraph (1) in case of a prior transaction described in subsection (a) with respect to such component corporation or a component corporation thereof), as the number of days in such taxable year before the day after such transaction bears to the total number of days in such taxable year.

For the purposes of section 742, in the case of a corporation which is a component corporation in a transaction described in subsection (a), in computing for any taxable year the Supplement A average base period net income of the acquiring corporation in such transaction or of a corporation of which such acquiring corporation becomes a component corporation, no account shall be taken of the excess profits net income of such component corporation for any period beginning with the day after such transaction.

(d) In the case of a taxpayer which is an acquiring corporation the base period shall be the four calendar years 1936 to 1939, both inclusive, except that, if the taxpayer became an acquiring corporation prior to September 1, 1940, the base period shall be the same as that applicable to its first taxable year ending in 1941.

(e) *Base period years.* In the case of a taxpayer which is an acquiring corporation its base period years shall be the four successive twelve-month periods beginning on the same date as the beginning of its base period.

(f) *Existence of acquiring corporation.* For the purposes of section 712(a), if any component corporation of the taxpayer was in existence before January 1, 1940, the taxpayer shall be considered to have been in existence before such date.

(g) *Component corporations of component corporations.* If a corporation is a component corporation of an acquiring corporation, under subsection (b) or under this subsection, it shall (except for the purposes of section 742(d) (1) and (2) and section 743(a) (1), (2), and (3)) also be a component corporation of the corporation of which such acquiring corporation is a component corporation.

(h) *Sole proprietorship.* For the purposes of sections 740(a) (1) (D), 740(b) (5), and 742(g), a business owned by a sole proprietorship shall be considered a partnership.

§ 35.740–1 *Purpose and scope of supplement A.* (a) The term "Supplement A," when used in these regulations, means sections 740 and 742 to 744. Supplement A provides rules governing the right to use the excess profits credit based on income and the method of computing such credit, in the case of certain "acquiring" corporations. An acquiring corporation is a domestic corporation which has absorbed one or more other domestic corporations, partnerships, or businesses owned by sole proprietorships in a transaction meeting the requirements set forth in section 740(a), which transaction is generally referred to in these regulations as a "Supplement A transaction." Each such absorbed corporation, partnership, or business owned by a sole proprietorship is designated a component corporation of the acquiring corporation. Furthermore, except for the purposes of section 742(d) (1) and (2) and section 743(a) (1), (2), and (3), if an acquiring corporation is later absorbed by another acquiring corporation, all of the component corporations of the first acquiring corporation become component corporations of the second acquiring corporation. A foreign corporation cannot be an acquiring corporation and neither a foreign corporation, a foreign partner-

[1] Part II, sections 740–761 of the Internal Revenue Code.

[2] Supplement A, sections 740–744 of the Internal Revenue Code.

ship, nor a business owned by a foreign sole proprietorship can be a component corporation (see section 744).

(b) The purpose of Supplement A is in general to attribute to an acquiring corporation the existence of corporations, partnerships, or businesses owned by sole proprietorships absorbed by it, together with the base period excess profits net income or deficit in excess profits net income and the net capital changes of such predecessors, in order (1) that a corporation the corporate life of which in substance, though not in form, includes the base period may use the excess profits credit based on income and (2) that a corporation composed in whole or in part of component corporations may compute its excess profits credit in the light of the base period experience of the entire enterprise. Accordingly, an acquiring corporation which was not actually in existence before the close of its base period, as defined in section 740(d), is given the right to use the excess profits credit based on income, provided that it has a component corporation actually in existence before January 1, 1940. In the case of an acquiring corporation which was actually in existence before January 1, 1940, and which uses an excess profits credit based on income, its average base period net income must be computed under section 713 or Supplement A, whichever method results in the greater average base period income. If an acquiring corporation computes its average base period net income under Supplement A, it is required to take into account the daily capital addition or reduction of each component corporation in computing its daily capital addition or reduction for each day after the Supplement A transaction, subject to the rules of section 743 and § 35.743–1.

§ 35.740–2 *Transactions whereby a corporation becomes an acquiring corporation.* (a) The types of transactions whereby a corporation can become an acquiring corporation are specifically described in section 740(a). In addition to statutory mergers and consolidations and the acquisition of property in a complete liquidation in which gain or loss is not recognized because of the provisions of section 112(b)(6) or the same section as contained in the Revenue Act of 1936 or 1938, only the following types of transactions are included:

(1) The acquisition by one corporation, in exchange in whole or in part for all of its stock of all classes (except qualifying shares), of substantially all the properties of another corporation. See section 112 (g) (1) (D).

(2) The acquistion by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded. See section 112 (g) (1) (C). In this type of transaction it is also required that the transferor corporation be forthwith completely liquidated pursuant to the plan under which the transfer of its properties was made and that the transaction of which the transfer is a part have the effect of a statutory merger or consolidation.

(3) The acquistion before October 1, 1940, by one corporation of properties of another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock of the acquiring corporation owned by the transferor corporation, but in determining whether the acquisition is solely as paid-in surplus or a contribution to capital the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded. As in the case of (2) above, it is also required that the transferor corporation be forthwith completely liquidated pursuant to the plan under which the transfer of properties was made and that the transaction of which the transfer is a part have the effect of a statutory merger or consolidation.

(4) The acquisition of substantially all the properties of a partnership in an exchange to which section 112 (b) (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5), or to which the corresponding provisions of a prior revenue law, is or was applicable. For the purposes of this paragraph a business owned by a sole proprietorship shall be considered a partnership.

(b) The types of transactions set forth in section 740(a), other than those set forth in section 740(a)(1)(C), either are embraced within the definition of a reorganization contained in section 112(g)(1), are transfers to a controlled corporation within the meaning of section 112(b)(5) and related sections, or are complete liquidations within the meaning of section 112(b)(6). Since Supplement A applies only to cases where there is a sufficient continuity of interest to justify treating a corporation by which the assets of another corporation, a partnership, or a business owned by a sole proprietorship have been acquired, as standing in the place of its predecessor, such transactions must satisfy all the requirements of the regulations prescribed under section 112 with respect to such transactions in order that the transferee corporation may be treated as an acquiring corporation.

(c) The purposes of section 740(c) are fourfold:

(1) In general, it confines the base period experience of a component corporation for the period before the day after the Supplement A transaction and its capital changes immediately before such transaction and for any prior period to the acquiring corporation in such transaction or to an acquiring corporation of which the first acquiring corporation is a component corporation.

(2) It permits a component corporation which does not terminate its existence in connection with the Supplement A transaction to take into account its entire base period experience (including that for the day of and the period before such transaction) for the purposes of sections 713 (f) and 742(h), except that its experience for the period before the day after the transaction cannot be taken into account for the purpose of applying the limitation prescribed in such sections as to the maximum amount of average base period net income. (See further § 35.742–1 (c).)

(3) It limits a component corporation which does not terminate its existence in connection with the Supplement A transaction, for the purpose of its credit under section 713 or section 742 in computing its excess profits tax for the taxable year in which the transaction occurs, to the proportionate part of its base period experience (after the application of section 740 (c) (1) as explained in subparagraphs (1) and (2) above in case of a prior transaction) which the number of days in such taxable year before the day after such transaction bears to the total number of days in such taxable year. If the component corporation goes out of existence on the day of the Supplement A transaction in a taxable year of such component which begins after December 31, 1941, and ends on the day of the Supplement A transaction (by reason of the termination of its existence, or for any other reason), it is entitled, subject to these regulations, to use its entire average base period net income for the purpose of computing its excess profits credit to be applied for such year. (For a corresponding provision in the case of the acquiring corporation in a Supplement A transaction occurring during its excess profits tax taxable year and an illustration of the application of such corresponding provision and section 740 (c) (2), see section 742 (f) (2) and § 35.742–3 (c).)

(4) It prevents a corporation acquiring a component corporation which does not terminate its existence in connection with the transaction from taking into account the base period experience of the component corporation after such transaction for the purpose of computing its excess profits credit based on income.

The operation of section 740 (c), from the standpoint of the purpose described in (1) above, is as follows: If a corporation is a component corporation in, for example, a transaction described in section 740 (a) (1) (A), occurring within the base period, and if the existence of such corporation is not terminated in connection with such transaction, its base period experience for the period before the day after such transaction is given to the acquiring corporation in such transaction or to an acquiring corporation of which the first acquiring corporation is a component corporation. Consequently, assuming that such component corporation remains in existence and continues business with properties acquired after such transaction, it will not, except for a limited purpose in computing average base period net income under section 713 (f) or section 742 (h), receive any benefit from its experience on the day of and prior to such transaction, nor can its experience on the day of and prior to such transaction be passed on to another acquiring corporation in a subsequent Supplement A transaction in which it is the component corporation.

The same rule is applicable to each successive Supplement A transaction to which such corporation is a party as a component corporation and in connection with which its existence is not terminated. Section 740 (c) applies to all types of Supplement A transactions, whether or not complete liquidation of the component corporation is specifically required in connection therewith.

If a Supplement A transaction occurred in a taxable year of the component corporation beginning in the base period, the excess profits net income of such component corporation for the portion of the taxable year after the transaction and for the prior portion of the taxable year (which is to be taken into account only by the acquiring corporation in such transaction) shall be computed on the basis of its income as shown by its books if the accounts are so kept that excess profits net income for each of such portions can be clearly and accurately determined. If the accounts are not so kept, the excess profits net income for the portion of the taxable year after the transaction shall be considered to be an amount which bears the same ratio to the excess profits net income for such taxable year as the number of days in such taxable year after such transaction bears to the total number of days in such taxable year, and the excess profits net income for the prior portion of such taxable year shall be considered to be the balance of the excess profits net income for such taxable year. However, if items of income and deduction are clearly and accurately determined to be attributable to particular portions of the taxable year, such items may be eliminated before the above proration is made, and after the proration is made such items will be added to (if items of income) or deducted from (if deductible items) the excess profits net income determined by the proration for the period to which such items are attributable.

The application of the provisions of section 740 (c) may be illustrated by the following example:

Example. A, B, and C, corporations which have always made their income tax returns on the calendar year basis, were in existence on January 1, 1936, and have continued in existence at all times since that date. On December 31, 1938, B acquired the properties of A in a transaction described in section 740 (a) (1) (A). A converted into cash the stock in B which it received in such transaction, and with the proceeds of such conversion acquired new properties. It operates such properties continuously down to the time C acquires such properties from A on October 19, 1943, in a transaction described in section 740 (a) (1) (A). A continues in business throughout 1943, operating properties which it purchased with the proceeds of the conversion of the stock in C received in the second transaction. The operation of section 740 (c) under circumstances outlined in this example is as follows:

(*a*) As to B. In determining its average base period net income under Supplement A for the purposes of the excess profits taxes for 1942 and 1943, B takes into account A's base period experience for 1936, 1937, and 1938. Inasmuch as the transaction involving B occurs within the base period, there is no capital addition or reduction of A to be transferred to B. See section 743.

(*b*) As to A. In determining its average base period net income under the general average method for the purposes of its excess profits tax for 1942, A takes into account its base period experience for 1939, but is denied the right to use its base period experience for 1936, 1937, and 1938. However, in determining its average base period net income under the growth formula, for purposes of its excess profits tax for 1942, A takes into account its base period experience for 1936, 1937, 1938, and 1939, except that such average cannot exceed its excess profits net income for 1939. When A determines its excess profits tax for 1943, it takes into account for the purpose of its average base period net income under the general average method only four-fifths (the ratio of the number of days in January 1, 1943–October 19, 1943, inclusive (292), over the number of days in 1943 (365)) of its base period experience for 1939; for the purpose of the growth formula it takes into account only four-fifths of its average base period experience determined under such formula. It does not take into account for the purpose of its tax for 1943 any of its capital addition or reduction attributable to the time immediately before the transaction. A will be entitled, however, to use the credit based on invested capital.

(*c*) As to C. Section 740 (c) is first applicable to C with respect to 1943. In determining its average base period net income under Supplement A for the purposes of its excess profits tax for that year, under the general average method C takes into account one-fifth of A's base period experience for 1939, and for the purpose of the growth formula (except in computing for such purpose the limitation as to the year of the highest excess profits net income) it takes into account one-fifth of A's average base period net income determined under such formula. See section 742 (f) (2). In determining C's average base period net income under Supplement A for the purposes of its excess profits tax for 1944, C takes into account all of A's base period experience for 1939 if the general average method is used, or all of A's base period experience for the purpose of the growth formula (except the limitation under such formula with respect to the year of the highest excess profits net income). Moreover, as the transaction involving C occurs after the close of the base period, A's daily capital addition and reduction as of the time immediately before the transaction are transferred to C. See section 743.

§ 35.740–3 *Base period and base period years of acquiring corporation.* The base period of a taxpayer, the average base period net income of which is computed under Supplement A, is

(a) The four calendar years 1936, 1937, 1938, and 1939, except in cases to which (b) applies, or

(b) If the taxpayer became an acquiring corporation prior to September 1, 1940, the 48 months preceding the date in 1940 on which its first excess profits tax taxable year ending in 1941 began or the date in 1940 which corresponds to the date in 1941 on which its first excess profits tax taxable year ending in 1941 began, as the case may be.

The base period once determined under this section for purposes of Supplement A is not affected by the fact that the taxpayer subsequently changes its taxable year.

The base period years of an acquiring corporation are four in number, being composed of the four successive 12-month periods beginning on the same date as the beginning of its base period. Thus, if the base period begins January 1, 1936, the four base period years are the four calendar years 1936, 1937, 1938, and 1939.

§ 35.740–4 *Partnerships and sole proprietorships under Supplement A.* A partnership (or a business owned by a sole proprietorship) can be a component corporation for the purposes of Supplement A, subject to the exceptions in section 740 (g). However, a partnership (or a business owned by a sole proprietorship) cannot be an acquiring corporation and, therefore, section 740 (g) cannot operate to make any of its predecessors component corporations of its acquiring corporation.

SEC. 741. ALLOWANCE OF EXCESS PROFITS CREDIT. [Added by sec. 201, Second Rev. Act 1940; Amended by sec. 14, Excess Profits Tax Amendments 1941; Not applicable to taxable years under these regulations (secs. 224 (b) and 228 (b), Rev. Act 1942).]

SEC. 742. SUPPLEMENT A AVERAGE BASE PERIOD NET INCOME. [Added by sec. 201, Second Rev. Act 1940; Amended by secs. 8 and 15, Excess Profits Tax Amendments 1941, and by sec. 228 (c), Rev. Act 1942.]

In the case of a taxpayer which is an acquiring corporation, its average base period net income (for the purpose of the credit computed under section 713) shall be the amount computed under section 713 or the amount of its Supplement A average base period net income, whichever is the greater. The Supplement A average base period net income shall be the amount computed without regard to subsection (h) of this section or computed under subsection (h) of this section, whichever is the greater. The Supplement A average base period net income shall be computed as follows:

(a) By ascertaining with respect to each of its base period years—

(1) The amount of its and each of its component corporation's excess profits net income for each of its and such component corporation's taxable years beginning with or within such base period year; or, in the case of each such taxable year of the taxpayer or of such component corporation, as the case may be, in which the deductions plus the credit for dividends received and the credit provided in section 26 (a) (relating to interest on certain obligations of the United States and its instrumentalities) exceeded the gross income, the amount of such excess;

(2) (A) The aggregate of the amounts of excess profits net income ascertained under paragraph (1); (B) the aggregate of the excesses ascertained under paragraph (1); and (C) the difference between the aggregates found under clause (A) and clause (B). If the aggregate ascertained under clause (A) is greater than the aggregate ascertained under clause (B), the difference shall for the purposes of subsection (b) be designated a "plus amount", and if the aggregate ascertained under clause (B) is greater than the aggregate found under clause (A), the difference shall for the purposes of subsection (b) be designated a "minus amount".

If, in the case of the taxpayer or any component corporation of the taxpayer, one and only one taxable year of the taxpayer or such component corporation, as the case may be, begins with or within such base period year and such taxable year is less than twelve months, the amount of the excess profits net income, or the amount of such excess of deductions plus the credit for dividends received and the credit provided in section 26 (a) (relating to interest on certain obligations of the United States and its instrumentalities) over gross income, as the case

may be, for such taxable year, shall be placed on an annual basis in the same manner as is provided in section 711 (a) (3). If more than one taxable year of the taxpayer or such component corporation, as the case may be, begins with or within such base period year, the aggregate of the amounts of excess profits net income minus the aggregate of the excesses of deductions plus the credit for dividends received and the credit provided in section 26 (a) (relating to interest on certain obligations of the United States and its instrumentalities) over gross income, or the aggregate of such excesses minus the aggregate of the amounts of excess profits net income, as the case may be, for such taxable years shall be adjusted to such extent as the Commissioner, under regulations prescribed by him with the approval of the Secretary, prescribes as necessary in order that such base period year shall reflect income for a period of twelve months. For the purposes of this section, a taxable year of a component corporation beginning within the base period which also begins with or within the taxable year of the acquiring corporation in which the acquisition occurred, or which also begins with or within the same base period year with which or within which began such taxable year of the acquiring corporation, shall be considered a taxable year of the acquiring corporation, and such taxable year shall be considered to have begun in the base period year with which or within which such taxable year of the acquiring corporation began.

(b) By adding the plus amounts ascertained under subsection (a) (2) for each year of the base period; and

(1) If the tax under this subchapter is being computed for a taxable year not beginning after December 31, 1941, by subtracting from such sum, if for two or more years of the basis [sic] period there was a minus amount, the sum of the minus amounts, excluding the greatest; or

(2) If the tax under this subchapter is being computed for a taxable year beginning after December 31, 1941, by subtracting from such sum the sum of the minus amounts. If the amount used under the preceding sentence for the lowest year is less than 75 per centum of the sum of the plus amounts reduced by the sum of the minus amounts for the other years in the base period divided by three, the amount which shall be used for such lowest year shall be 75 per centum of the amount last ascertained.

(c) By dividing the amount ascertained under subsection (b) by four.

(d) In no case shall the average base period net income be less than zero. In the case of a taxpayer which becomes an acquiring corporation in any taxable year beginning after December 31, 1939, if, on September 11, 1940, and at all times until the taxpayer became an acquiring corporation—

(1) the taxpayer owned not less than 75 per centum of each class of stock of each of the qualified component corporations involved in the transaction in which the taxpayer became an acquiring corporation; or

(2) one of the qualified component corporations involved in the transaction owned not less than 75 per centum of each class of stock of the taxpayer, and of each of the other qualified component corporations involved in the transaction,

the average base period net income of the taxpayer shall not be less than (A) the average base period net income of that one of its qualified component corporations involved in the transaction the average base period net income of which is greatest, or (B) the average base period net income of the taxpayer computed without regard to the base period net income of any of its qualified component corporations involved in the transaction. As used in this subsection, the term "qualified component corporation" means a component corporation which was in existence on the date of the beginning of the taxpayer's base period.

(e) For the purposes of subsection (a) (1) of this section—

(1) If neither the taxpayer corporation nor any of its component corporations was actually in existence on December 31, 1936, the excess profits net income of each such corporation for each base period year at no time during which any of such corporations was actually in existence, shall (except in the case of a corporation which became a component corporation of its acquiring corporation before the beginning of the acquiring corporation's first taxable year which began in 1940) be an amount equal to 8 per centum of the excess of—

(A) in the case of any such corporation to which paragraph (2) is not applicable, the daily invested capital of such corporation for the first day of its first taxable year under this subchapter beginning in 1940 over

(B) an amount equal to the same percentage of such daily invested capital as would be applicable under section 720 in reduction of the average invested capital of such corporation for the last taxable year beginning in 1939 if such section had been applicable to such year (computed as if the admissible and inadmissible assets of any other such corporation with respect to which it became, in such taxable year, an acquiring corporation, had been held by it).

(2) In case the transaction by which a corporation became a component corporation of its acquiring corporation occurred in the last taxable year of such component corporation beginning in 1939 but on a day in a taxable year of such acquiring corporation beginning in 1940, the excess profits net income of such component corporation for each base period year described in paragraph (1) shall be an amount equal to 8 per centum of the excess of—

(A) the daily invested capital of such component corporation for such day, over

(B) an amount equal to the same percentage of such daily invested capital as would be applicable under section 720 in reduction of the average invested capital of such component corporation for the twelve-month period ending with the preceding day if such twelve-month period constituted a taxable year and such section had been applicable to such taxable year.

(3) In case any corporation described in paragraph (1) owned stock in any other such corporation on the first day of such owning corporation's first taxable year under this subchapter beginning in 1940, the amounts computed under subparagraphs (A) and (B) of paragraphs (1) and (2) with respect to such corporations shall be adjusted, under regulations prescribed by the Commissioner with the approval of the Secretary, to such extent as may be necessary to prevent the excess profits net income of such corporations for the base period years described in paragraph (1) from reflecting money or property having been paid in by either of such corporations to the other for stock or as paid-in surplus or as a contribution to capital, or from reflecting stock of either having been paid in for stock of the other or as paid-in surplus or as a contribution to capital. For the purposes of this paragraph, stock in either such corporation which has in the hands of the other corporation a basis determined with reference to the basis of stock previously acquired by the issuance of such other corporation's own stock shall be deemed to have been paid in for the stock of such other corporation.

(4) In determining whether, for any taxable year, the deductions plus the credit for dividends received and the credit provided in section 26 (a) (relating to interest on certain obligations of the United States and its instrumentalities) exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711 (b) (1) shall be made.

(f) (1) If, after December 31, 1935—

(A) the taxpayer acquired stock in another corporation, and thereafter such other corporation became a component corporation of the taxpayer, or

(B) a corporation (hereinafter called "first corporation") acquired stock in another corporation (hereinafter called "second corporation"), and thereafter the first and second corporations became component corporations of the taxpayer,

then to the extent that the consideration for such acquisition was not the issuance of the taxpayer's or first corporation's, as the case may be, own stock, the Supplement A average base period net income of the taxpayer shall be reduced, and the transferred capital addition and reduction adjusted, in respect of the income and capital addition and reduction of the corporation whose stock was so acquired and in respect of the income and capital addition and reduction of any other corporation which at the time of such acquisition was connected directly or indirectly through stock ownership with the corporation whose stock was so acquired and which thereafter became a component corporation of the taxpayer, in such amounts and in such manner as shall be determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. For the purposes of this paragraph, stock which has, in the hands of the taxpayer or first corporation, as the case may be, a basis determined with reference to the basis of stock previously acquired by the issuance of the taxpayer's or first corporation's, as the case may be, own stock, shall be considered as having been acquired in consideration of the issuance of the taxpayer's or first corporation's, as the case may be, own stock.

(2) If during the taxable year for which tax is computed under this subchapter the taxpayer acquires assets in a transaction which constitutes it an acquiring corporation, the amount includible under subsection (a), attributable to such transaction, shall be limited to an amount which bears the same ratio to the amount computed without regard to this subsection as the number of days in the taxable year after such transaction bears to the total number of days in such taxable year.

(g) In the case of a partnership which is a component corporation by virtue of section 740 (b) (5), the computations required by this Supplement shall be made, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, as if such partnership had been a corporation. For the purpose of such computations, in making the adjustment for income taxes required by section 711 (b) (1) (A), the partnership so regarded as a corporation shall be considered as having distributed all its net income as a dividend.

(h) *Increased earnings in last half of base period*—(1) *General rule.* The Supplement A average base period net income determined under this subsection shall be computed by ascertaining for each half of the base period the sum of the plus amounts determined under subsection (a) reduced if for any year in such half a minus amount was determined by the minus amount for such year. If the amount ascertained for the second half exceeds the amount ascertained for the first half, the Supplement A average base period net income shall be the sum, divided by two, of the amount so ascertained for the second half plus one-half of such excess, except that it shall not exceed the largest plus amount determined under subsection (a) with respect to any base period year.

(2) *Limitation on amount includible for certain taxable years ending after May 31, 1940.* For the purposes of this subsection the excess profits net income of any corporation for any taxable year beginning in 1939 and ending after May 31, 1940, shall in no case exceed an amount computed as follows:

(A) By reducing the excess profits net income by an amount which bears the same ratio thereto as the number of months after May 31, 1940, bears to the total number of months in such taxable year; and

(B) By adding to the amount ascertained under subparagraph (A) an amount which bears the same ratio to the excess profits net income for the last preceding taxable year as such number of months after May 31, 1940, bears to the number of months in such preceding year. The amount added under this subparagraph shall not exceed the amount of the excess profits net income for such last preceding taxable year.

(C) If the number of months in such preceding taxable year is less than such number of months after May 31, 1940, by adding to the amount ascertained under subparagraph (B) an amount which bears the same ratio to the excess profits net income for the second preceding taxable year as the excess of such number of months after May 31, 1940, over the number of months in such preceding taxable year bears to the number of months in such second preceding taxable year.

§ 35.742–1 *General rules for determining Supplement A average base period net income*—(a) *Introductory.* In the case of an acquiring corporation which was actually in existence before January 1, 1940, its average base period net income, for the purposes of the excess profits credit based on income, shall be (1) the amount computed under section 713 with reference to its base period experience but without reference to the base period experience of its component corporations; or (2) the amount of its Supplement A average base period net income, computed under section 742 with reference to its base period experience and also with reference to the base period experience of its component corporations, whichever of such amounts is the greater. In the case of an acquiring corporation which was not actually in existence before January 1, 1940, but which was constructively in existence before such date through a component corporation, its average base period net income, for the purposes of such credit, shall be its Supplement A average base period net income, computed under section 742.

In the case of an acquiring corporation which desires to compute its average base period net income under Supplement A, section 742 is not intended to require such corporation to include in its return the computations of base period income under section 713 for the purpose of showing that the computations under Supplement A result in the greater average base period net income. A return setting forth one set of computations of base period income shall be acceptable. A return filed in this manner shall be audited as filed, regardless of whether the omitted computation of average base period net income would result in a lesser tax. If a corporation files a return which contains only one set of computations of base period income, it is not thereby precluded from establishing that the computations used resulted in an overpayment of the excess profits tax or from filing a claim for the refund thereof.

The Supplement A average base period net income of an acquiring corporation shall be (1) the amount computed under section 742 without regard to paragraph (h) of such section, or (2) the amount computed under such paragraph, whichever of such amounts is the greater. If neither the acquiring corporation nor any of its component corporations was in existence at any time during a base period year, then, in computing the Supplement A average base period net income of the acquiring corporation, section 742 (e) (1), (2), and (3) is applicable regardless of whether the computation is made under section 742 (h) or without regard to such section.

(b) *General average method*—(1) *In general.* The following steps are required for the computation of the Supplement A average base period net income under section 742 without regard to paragraph (h) of such section (for exceptions and limitations as to amounts of excess profits net income or deficit to be included in average base period, see § 35.742–3, and for computation of excess profits net income for base period years during which neither the taxpayer nor any of its component corporations was in existence at any time, see § 35.742–4):

(i) The excess profits net income or the excess of deductions plus the credit for dividends received and the credit provided in section 26 (a) over gross income (hereinafter referred to as "deficit in excess profits net income") of the acquiring corporation and each component corporation for each taxable year beginning with or within a base period year of the acquiring corporation must be determined.

(ii) The group excess profits net income or group deficit in excess profits net income for each base period year of the acquiring corporation, i. e., the aggregate of the amounts determined with respect to each corporation separately for taxable years beginning with or within such base period year, must be determined as provided in subparagraph (3) of this paragraph.

(iii) The taxpayer's Supplement A average base period net income is then ascertained by determining the aggregate of the group excess profits net incomes and deficits in excess profits net income (with adjustment in certain cases of the amount for the lowest year) and dividing by 4, as provided in subparagraph (4) of this paragraph.

(2) *Determination of excess profits net income or deficit in excess profits net income of acquiring corporation and each component corporation.* The first step in computing the average base period net income of an acquiring corporation is the determination of the excess profits net income or deficit in excess profits net income of the acquiring corporation and each component corporation for each taxable year beginning with or within a base period year of the acquiring corporation. Such excess profits net income or deficit in excess profits net income shall be computed with the adjustments provided in section 711 (b).

In the case of a component corporation which is a partnership or a business owned by a sole proprietorship, its excess profits net income or deficit in excess profits net income for each taxable year in the base period shall be determined as though such partnership or business owned by a sole proprietorship had been a corporation for each such year. Among the adjustments which are necessary in computing the excess profits net income or deficit in excess profits net income are the following:

(i) A reasonable deduction for salary or compensation to each partner or the sole proprietor for personal services actually rendered shall be allowed;

(ii) The credit for dividends received provided by section 26 (b) and section 711 (b) (1) (G) shall be allowed;

(iii) The treatment of capital gains and losses shall be that applicable to corporations;

(iv) The deduction for charitable contributions shall be that allowed by section 23 (q);

(v) The income taxes allowed as a deduction under section 23 (c) shall be computed as though the partnership or business owned by a sole proprietorship were a corporation and in computing such taxes the partnership or business owned by a sole proprietorship shall be deemed to have distributed all its net income as a dividend.

(3) *Determination of group excess profits net income or deficit in excess profits net income.* The group excess profits net income or deficit in excess profits net income of an acquiring corporation for each base period year is determined by adding together the excess profits net incomes of the several corporations determined under subparagraph (2) of this paragraph for each taxable year beginning with or within such base period year and subtracting from such sum the sum of the deficits in excess profits net income so determined for each such taxable year, with the exceptions and limitations set forth in § 35.742–2 (a). If the sum of the excess profits net incomes for such base period year exceeds the sum of the deficits in excess profits net income for such base period year, the difference is the group excess profits net income for such base period year. If the sum of the deficits in excess profits net income exceeds the sum of the excess profits net incomes, the difference is the group deficit in excess profits net income for such base period year. This paragraph may be illustrated by the following examples:

Example (1). The X Corporation, which was organized prior to 1936, and which has always made its income tax returns on the calendar year basis, is computing its excess profits tax for the calendar year 1942. In 1939 it became an acquiring corporation of the Y Corporation and the Z Corporation, both of which were organized prior to January 1, 1936. The Y Corporation made its income tax returns on the basis of the fiscal year beginning July 1, and the Z Corporation made its income tax returns on the calendar year basis. For the calendar year 1936 the X Corporation had an excess profits net income of $50,000, and the Z Corporation had an excess

profits net income of $20,000. For the fiscal year beginning July 1, 1936, the Y Corporation had an excess profits net income of $30,000. For its first base period year, i. e., the calendar year 1936, the group excess profits net income of X, the acquiring corporation, is $100,000, computed as follows:

Excess profits net income of X Corporation for 1936	$50,000
Plus:	
Excess profits net income of Z Corporation for 1936	20,000
Excess profits net income of Y Corporation for fiscal year beginning July 1, 1936	30,000
Group excess profits net income for 1936	100,000

The Y Corporation's fiscal year ending June 30, 1936, cannot be taken into account since it is a taxable year which did not begin with or within the first base period year.

Example (2). If, in the case of the same corporations as in example (1), for the calendar year 1937 the X Corporation had an excess profits net income of $75,000 and the Z Corporation had an excess profits net income of $30,000 and if the Y Corporation for the fiscal year beginning July 1, 1937, had a deficit in excess profits net income of $5,000, the X Corporation would have a group excess profits net income for its second base period, year, i. e., the calendar year 1937, of $100,000, computed as follows:

Excess profits net income of X Corporation for 1937	$75,000
Plus: Excess profits net income of Z Corporation for 1937	30,000
Total	105,000
Less: Deficit in excess profits net income of Y Corporation for fiscal year beginning July 1, 1937	5,000
Group excess profits net income for 1937	100,000

Example (3). If for the calendar year 1938 the X Corporation had an excess profits net income of $40,000 and the Z Corporation had a deficit in excess profits net income of $50,000, and if the Y Corporation had an excess profits net income of $5,000 for the fiscal year beginning on July 1, 1938 (which ended before the acquisition in 1939), the X Corporation would have a group deficit in excess profits net income for its third base period year, i. e., the calendar year 1938, of $5,000, computed as follows:

Deficit in excess profits net income of Z Corporation for 1938		$50,000
Less:		
Excess profits net income of X Corporation for 1938	$40,000	
Excess profits net income of Y Corporation for fiscal year beginning July 1, 1938	5,000	
		45,000
Group deficit in excess profits net income for 1938		5,000

(4) *Determination of average base period net income.* The average base period net income of an acquiring corporation, in general, is the sum of the group excess profits net incomes for the base period years for which there were group excess profits net incomes, reduced by the sum of the group deficits in excess profits net income for the base period years for which there were group deficits in excess profits net income, the remainder being divided by four. However, in cases in which the lowest amount for any base period year is less than 75 percent of the average for the other three years, there shall be substituted for such lowest amount an amount of excess profits net income equal to 75 percent of such average, and then the average base period net income shall be computed for the four base period years as under the general rule. In no case shall the average base period net income be less than zero. This paragraph may be illustrated by the following example:

Example. The group net income or group deficit in excess profits net income of the P Corporation for each of its base period years is as follows (a group deficit in excess profits net income being preceded by a minus sign):

First base period year	$100,000
Second base period year	−50,000
Third base period year	−25,000
Fourth base period year	75,000

The average base period net income of the P Corporation is $46,875, computed as follows:

(1) Group deficit in excess profits net income for lowest year		−$50,000
Average for other 3 years ($100,000 − $25,000 + $75,000 ÷ 3)		50,000
75 percent of average for other 3 years		$37,500
(2) Group excess profits net income for first year		100,000
Plus: Group excess profits net income for second year (as determined above for lowest year)		37,500
Group excess profits net income for fourth year		75,000
Total		212,500
Less: Group deficit in excess profits net income for third year		−25,000
Remainder		187,500
Average base period net income ($187,500 ÷ 4)		46,875

Section 742 (d) provides for a minimum average base period net income in the case of a taxapayer which becomes an acquiring corporation in a transaction taking place in a taxable year beginning after December 31, 1939, if, on September 11, 1940, and at all times thereafter until the transaction takes place, either the taxpayer owns at least 75 percent of each class of stock of each qualified component corporation involved in the transaction, or one of such qualified component corporations owns at least 75 percent of each class of stock of the taxpayer and each of the other qualified component corporations. In such case the average base period net income of the taxpayer shall be determined as provided in section 742 (d). The term "qualified component corporation," as used in this paragraph, means a component corporation which was in existence on the date of the beginning of the taxpayer's base period. For the purposes of this paragraph section 740 (g) is not applicable.

§ 35.742–2 *Computation of average base period net income under section 742 (h); increased earnings in last half of base period*—(a) *In general.* The determination of the Supplement A average base period net income under the method provided in section 742 (h) is operative only if the sum of the group excess profits net incomes of the taxpayer for the second half of its base period, reduced by the sum of its deficits in excess profits net income for such half, is greater than such sum so reduced for the first half and the average base period net income determined under section 742 (h) is greater than the amount determined under section 742 without regard to paragraph (h) of such section. The following steps are required for the computation of the Supplement A average base period net income under the method provided in section 742 (h):

(1) The excess profits net income or deficit in excess profits net income of the acquiring corporation and of each component corporation for each taxable year beginning with or within each base period year of the acquiring corporation is determined as provided in § 35.742–1 (b).

(2) The group excess profits net income or group deficit in excess profits net income of the acquiring corporation for each of its base period years is determined as provided in § 35.742–1 (b).

(3) There is computed for each half of the base period the sum of the group excess profits net incomes for the base period years in such half, reduced, if for one or more of such years there was a group deficit in excess profits net income, by the sum of such group deficits. In making this computation, the lowest amount for any base period year is not adjusted as in the case of the computation under the general average method described in § 35.742–1 (b).

(4) The excess of the amount ascertained for the second half over the amount ascertained for the first half is divided by 2.

(5) The amount ascertained under subparagraph (4) is added to the amount ascertained under subparagraph (3) for the second half of the base period.

(6) The amount found under subparagraph (5) is divided by 2.

(7) The amount ascertained under subparagraph (6) shall be the Supplement A average base period net income determined under the method provided in section 742 (h), except that the Supplement A average base period net income so determined shall in no case be greater than the highest group excess profits net income for any base period year. For the purposes of this limitation, in the case of a corporation which became a component corporation in a Supplement A transaction occurring in a taxable year beginning in the base period, no account shall be taken of its excess profits net income before the day after such transaction or of any of its component corporations acquired before the day after such transaction. (See section 740 (c) (1).)

The computation of the Supplement A average base period net income under the method provided in section 742 (h) may be illustrated by the following examples:

Example (1). The X Corporation, an acquiring corporation, has the following amounts of group excess profits net incomes for the base period years in its base period: 1936, $100,000 1937, $200,000; 1938, $300,000; and 1939, $400,000. Its Supplement A average base period net income under the method provided in section 742 (h) is $400,000, computed as follows:

(i) Sum of group excess profits net incomes for second half of base period ($300,000 plus $400,000)	$700,000
(ii) Sum of group excess profits net incomes for first half of base period ($100,000 plus $200,000)	300,000
(iii) Excess of item (i) over item (ii)	400,000
(iv) One-half of item (iii) ($400,000 divided by 2)	200,000
(v) Sum of item (i) plus item (iv) ($700,000 plus $200,000)	900,000
(vi) Item (v) divided by 2 ($900,000 divided by 2)	450,000
(vii) Highest group excess profits net income for any base period year (1939)	400,000
(viii) Supplement A average base period net income (item (vii) since such item is less than item (vi))	400,000

Example (2). The X Corporation was in existence throughout its base period and has always made its income tax returns on the calendar year basis. On July 1, 1938, it transferred its property to another corporation in a transaction described in section 740 (a) (1) (A). It immediately exchanged the stock received in such transaction for other assets and continued in business. On December 31, 1938, it acquired all of the assets of the Y Corporation in a Supplement A transaction. The Y Corporation was in existence on January 1, 1936, and made its income tax returns on the calendar year basis. The excess profits net incomes of the X Corporation for 1936, 1937, and 1938 were, respectively, $75,000, $125,000, and $350,000. With respect to the last amount, $200,000 thereof is attributable to the part of 1938 after the transaction in which the X Corporation was a component corporation and $150,000 is attributable to the prior part of such year. The excess profits net incomes of the Y Corporation for 1936, 1937, and 1938 were, respectively, $25,000, $75,000, and $200,000. The excess profits net income of the X Corporation for 1939 was $300,000. In applying the method provided in section 742 (h), the X Corporation is required to take into account its excess profits net incomes for the period before the date of the transaction in which it was a component corporation, but, for the purposes of the limitation as to the maximum amount of Supplement A average base period net income, it is not permitted to take into account such income. (See section 740 (c) (1).) Accordingly, its group excess profits net incomes for the base period years are, respectively, $100,000, $200,000, $550,000, and $300,000, and its Supplement A average base period net income is $400,000, computed as follows:

(i) Sum of group excess profits net incomes for second half of base period ($550,000 plus $300,000)	$850,000
(ii) Sum of group excess profits net incomes for first half of base period ($100,000 plus $200,000)	300,000
(iii) Excess of item (i) over item (ii)	$550,000
(iv) One-half of item (iii) ($550,000 divided by 2)	275,000
(v) Sum of item (i) plus item (iv) ($850,000 plus $275,000)	1,125,000
(vi) Item (v) divided by 2 ($1,125,000 divided by 2)	562,500
(vii) Highest group excess profits net income for any base period year for purposes of limitation as to maximum average income (1938). (Effective income for 1938 for purposes of limitation is $400,000 after excluding $150,000 attributable to part of year preceding July 2, 1938)	400,000
(viii) Supplement A average base period net income (item (vii) since such item is less than item (vi)	400,000

The restriction upon the limitation illustrated in the last example applies also in the case of a component corporation computing the average base period net income under section 713 (f) and not under section 742 (h), for the purpose of its credit for a taxable year beginning after December 31, 1941 (see section 740 (c) (1)). Thus, if in example (2) above, the X Corporation had continued in existence without acquiring the assets of the Y Corporation and, as in the example, its excess profits net income for 1939 was $300,000, its average base period net income computed under section 713 (f) (without the benefit of the experience of Y Corporation) would be limited to $300,000. The otherwise highest amount of excess profits net income, $350,000 for 1938, would be reduced under the restriction in section 740 (c) to $200,000 by the elimination of $150,000 attributable to the part of the taxable year preceding July 2, 1938.

(b) *Limitation in case of taxable year beginning in 1939 and ending after May 31, 1940.* For the purpose of computing the Supplement A average base period net income under the method provided in section 742 (h), section 742 (h) (2) provides certain limitations on the amount of the excess profits net income for any taxable year of the taxpayer or a component corporation beginning in 1939 and ending after May 31, 1940.

Section 742 (h) (2) (A) and (B) may be illustrated by the following example:

Example. The X Corporation makes its income tax returns on the basis of a fiscal year ending September 30. It had an excess profits net income of $400,000 for the fiscal year ended September 30, 1939. Its excess profits net income for the fiscal year ended September 30, 1940, before the application of section 742 (h) (2) (A) and (B), is $600,000. Four months of the latter fiscal year are after May 31, 1940. Under section 742 (h) (2) (A) and (B) the excess profits net income of the corporation for the fiscal year ended September 30, 1940, is $533,333.33, computed as follows:

(1) Excess profits net income before application of section 742 (h) (2) (A) and (B)	$600,000.00
(2) Amount by which item (1) is to be reduced under section 742 (h) (2) (A) (1/12 of $600,000)	200,000.00
(3) Item (1) less item (2) ($600,000 minus $200,000)	$400,000.00
(4) Amount to be added to item (3) under section 742 (h) (2) (B) (1/12 of $400,000, the amount of excess profits net income for the fiscal year ended September 30, 1939)	133,333.33
(5) Excess profits net income for fiscal year ended September 30, 1940, after application of section 742 (h) (2) (item (3) plus item (4), or $400,000 plus $133,333.33)	533,333.33

If on December 31, 1940, the X Corporation acquired the Y Corporation in a Supplement A transaction, and if the Y Corporation had made its income tax returns on the calendar year basis and had an excess profits net income for the calendar year 1939 of $100,000, the X Corporation's group excess profits net income for 1939 would be $633,333.33 ($533,333.33 plus $100,000).

Section 742 (h) (2) (C) may be illustrated by the following example:

Example. The last three taxable years in the base period of the Z Corporation and the number of months in, and the excess profits net income for, such taxable years are as follows:

Taxable years		Number of months	Excess profits net income
Beginning—	Ending—		
July 1, 1938	June 30, 1939	12	$400,000
July 1, 1939	September 30, 1939	3	75,000
October 1, 1939	September 30, 1940	12	600,000

Under section 742 (h) (2) the excess profits net income of the corporation for the fiscal year ended September 30, 1940, is $508,333.33, computed as follows:

(i) Excess profits net income before application of section 742 (h) (2) (A) and (B)	$600,000.00
(ii) Amount by which item (i) is to be reduced under section 742 (h) (2) (A) (4/12 of $600,000)	200,000.00
(iii) Item (i) less item (ii) ($600,000 minus $200,000)	400,000.00
(iv) Amount to be added to item (iii) under section 742 (h) (2) (B) (4/3 of $75,000 but not in excess of $75,000)	75,000.00
(v) Amount to be added to item (iii) under section 742 (h) (2) (C) (1/12 of $400,000)	33,333.33
(vi) Excess profits net income for fiscal year ended September 30, 1940, after application of section 742 (h) (2) (sum of items (iii), (iv), and (v), or $400,000 plus $75,000 plus $33,333.33)	508,333.33

The Z Corporation's excess profits net income for the two taxable years beginning in 1939 are required to be placed on an annual basis in order to determine its excess profits net income for the base period year 1939. (See section 742 (a).) For this purpose, its excess profits net income for the taxable year beginning October 1, 1939, and ending September 30, 1940, is the amount as reduced by the application of section 742 (h) (2). If on December 31, 1941, the Z Corporation acquired a component corporation

in a Supplement A transaction, and if the component corporation had made its income tax returns on the calendar year basis, Z Corporation's group excess profits net income for the base period year 1939 would be the sum of (A) the excess profits net income of the component corporation for the calendar year 1939, plus (B) the amount resulting from placing Z Corporation's actual excess profits net income for the short taxable year beginning on July 1, 1939, and its excess profits net income for the fiscal year ending September 30, 1940 (as reduced under section 742 (h) (2)), on an annual basis.

§ 35.742–3 *Exceptions and limitations as to amounts of excess profits net income or deficit to be included in Supplement A average base period net income; applicable under both general average method and increased earnings method.* The amount of excess profits net income or deficit in excess profits net income of an acquiring corporation or a component corporation for a taxable year beginning with or within a base period year which may be included in computing the group excess profits net income or deficit in excess profits net income for such base period year is to be determined subject to the exceptions and limitations set forth in paragraphs (a), (b), and (c) of this section.

(a) *Adjustment under section 742 (a) for change in taxable year*—(1) *Introductory.* Section 742 (a) requires adjustment where an acquiring corporation or component corporation has one or more taxable years beginning with or within a base period year other than one taxable year of 12 months.

If the taxpayer or a component corporation has only one taxable year beginning with or within a base period year and such taxable year is less than 12 months, or if the taxpayer or a component corporation has two or more taxable years beginning with or within a base period year, the experience of the taxpayer or of such component for such short taxable year or for such taxable years shall be adjusted to reflect 12 months' experience by either of two methods described in this paragraph. The first method is hereafter referred to as the daily average method and the second method is hereafter referred to as the actual experience method. The second method may be used only if the taxpayer establishes to the satisfaction of the Commissioner that the actual experience method will more clearly reflect actual group excess profits net income (or deficit) for the base period year. See (4) of this paragraph. In either case, the adjustment is to be made only as provided in this paragraph under the heading "daily average method" or "actual experience method," whichever method is applicable. Only one method may be used for the same base period year. Under either method, any period, the experience of which is not to be included in the average base period net income of the taxpayer under the rules provided in section 740 (c), is not to be considered any part of a taxable year of the acquiring corporation or the component.

(2) *Short taxable year or two taxable years other than year of Supplement A transaction.* If only one taxable year of the taxpayer or of a component begins in a base period year and such taxable year is less than 12 months, or if two or more taxable years of the taxpayer or of a component begin in a base period year, the following adjustment shall be made if the Supplement A transaction did not occur in such base period year or in a taxable year of the acquiring corporation beginning in such base period year:

Daily average method. Under this method, the aggregate of the amounts of excess profits net income minus the aggregate of the amounts of deficit in excess profits net income, or vice versa, as the case may be, for the period to be adjusted (i. e., such short taxable year or such two or more taxable years, as the case may be) shall be placed on an annual basis by dividing by the number of days in such period and by multiplying by the number of days in the base period year.

Actual experience method. Under this method, the actual excess profits net income (or deficit) for the period of 12 months beginning with the first day of the period to be adjusted (i. e., such short taxable year or such two or more taxable years, as the case may be) shall be considered the total excess profits net income (or deficit) of the acquiring corporation or of the component, as the case may be, which is to be attributed to the base period year under section 742 (a) (1). If such 12-month period ends after May 31, 1940, or with or after a month in which a Supplement A transaction occurs, the experience after such date or for and after such month, whichever first occurs, shall not be used. In such case, there shall be added to the experience used the experience for as many consecutive months immediately preceding the beginning of the period of months used as will produce an aggregate period of 12 months. If 12 months' experience cannot be obtained by either of the above rules, the actual experience method may not be used.

(3) *Two taxable years including year of Supplement A transaction*—(i) *General description.* If two or more taxable years of a component corporation or if two or more taxable years of the taxpayer (including as such any year of the component, as provided in the following sentence) begin in a base period year and if the Supplement A transaction occurs in such base period year or in a taxable year of the acquiring corporation beginning in such base period year, adjustment shall be made in the two categories of cases described below and in the manner set forth below. For this purpose, section 742 (a) provides that a taxable year of a component corporation:

(*a*) Which begins within the base period and which also begins with or within the taxable year of the acquiring corporation in which the acquisition occurred, or

(*b*) Which begins with or within the same base period year with which or within which began the taxable year of the acquiring corporation in which the acquisition occurred,

shall be treated as a taxable year of the acquiring corporation and as if it began in the base period year with which or within which such taxable year of the acquiring corporation began. The adjustment to be made is set forth in (ii) and (iii) below.

(ii) *First category.* In the first category are cases in which, in a base period year, the first taxable year of each corporation, which became a component in any taxable year of the acquiring corporation beginning in such base period year, began on the same date, if (*a*) the acquiring corporation's first taxable year in such base period year also began on such date, or (*b*) the acquiring corporation's first taxable year upon its coming into existence began on the date of a Supplement A transaction in such base period year.

Daily average method. In such cases, a group excess profits net income or group deficits in excess profits net income, as the case may be, for only the acquiring corporation and any such component corporations shall be determined for such base period year, in the manner provided in § 35.742–1 (b) (3). This amount shall be the excess profits net income or deficit in excess profits net income, as the case may be, of such acquiring corporation (including such component corporations) for such base period year, unless the period from the beginning of the first taxable year of any such component corporation beginning in such base period year to the end of the last taxable year of such acquiring corporation beginning in such base period year, inclusive, is not a period of 12 months. In such latter case, the amount thus determined shall be placed on an annual basis by dividing by the total number of days in such period and by multiplying by the number of days in such base period year. The rules applicable in this first category may be illustrated by the following examples:

Example (1). The A Corporation computes its income tax on the calendar year basis. On July 1, 1936, the A Corporation is reorganized into the B Corporation in a Supplement A transaction. The B Corporation computes its income tax on the basis of the fiscal year beginning July 1 until it goes on a calendar year basis beginning January 1, 1937. Although A's short period is considered a taxable year of B, since the total period of both taxable years is 12 months, the excess profits net income, or the deficit in excess profits net income, of the B Corporation for 1936 is the sum of the excess profits net income (or deficit) for each of the two short taxable years (not placed on an annual basis) of A and B for the calendar year 1936.

Example (2). The C Corporation and the D Corporation compute their income taxes on the calendar year basis. On July 1, 1937, C and D consolidated in a Supplement A transaction to form the E Corporation which thereafter computed its income tax on a fiscal year basis beginning July 1 (until 1940 when it went on a calendar year basis). The excess profits net income, or the deficit in excess profits net income, of E for the base period year 1937, is determined by computing the excess of the aggregate of the excess profits net incomes of C and D for the period January 1, 1937–July 1, 1937, inclusive, and of E for the period July 1, 1937–June 30, 1938, over the deficit in excess profits net income of C, D, and E, if any, for each of their respective periods, or the excess of the deficits, as the case may be; by divid-

ing such excess by the number of days in the period January 1, 1937, through June 30, 1938; and by multiplying the resulting quotient by 365.

Example (3). The F, G, and H Corporations were in existence prior to 1936 and all computed their income tax on a fiscal year basis beginning March 1. On July 1, 1937, the F Corporation transfers its assets to the H Corporation in a Supplement A transaction and continues in existence with new assets acquired in exchange for the stock of H. On December 31, 1937, the H Corporation acquires the assets of the G Corporation in a Supplement A transaction and the G Corporation goes out of existence. The H Corporation changes to a calendar year basis beginning January 1, 1938. Assuming the figures shown below, the excess profits net income of the H Corporation for the base period year 1937 is $365,000, computed as follows:

(1) Excess profits net income of—	
G, for period March 1, 1937–December 31, 1937	$200,000
H, for period March 1, 1937–December 31, 1937	186,000
(2) Aggregate excess profits incomes for taxable years beginning in base period	$386,000
(3) Deficit in excess profits net income of F, for period March 1, 1937–July 1, 1937 (deficit)	80,000
(4) Excess of (2) over (3)	306,000
(5) Number of days in period March 1, 1937–December 31, 1937	306
(6) Excess profits net income placed on an annual basis ($306,000÷306×365)	$365,000

Actual experience method. The treatment under this method in cases in the first category applies only if it would be necessary under the daily average method to place the experience for the taxable years on an annual basis, as provided above under such method. Under the actual experience method, the actual excess profits net income (or deficit) of the corporations falling within this category for the period of 12 months beginning with the first day of the first taxable year in such base period year of any such component corporation shall be considered the total (or group) excess profits net income (or deficit) of such corporations for all their taxable years beginning in such base period year. If such 12-month period ends after May 31, 1940, or with or after a month in which a Supplement A transaction occurs in a taxable year of the acquiring corporation not beginning in such base period year, the experience after such date or for and after such month, whichever first occurs, shall not be used. In such case, there shall be added to the experience used the experience for as many consecutive months immediately preceding the beginning of the period of months used as will produce an aggregate period of 12 months. The first rule may be illustrated by example (2) above, where, under the actual experience method, the actual experience of the C, D, and E Corporations for the calendar year 1937 would be used. The second rule may be illustrated by example (3) above, if it is assumed that the first rule is not applicable by reason of another Supplement A transaction occurring in January 1938. In such case, under the actual experience method, the actual experience of the F, G, and H Corporations for the period of 12 months ending with December 31, 1937, is to be used.

(iii) *Second category.* In the second category of cases under section 742 (a), previously referred to, are all cases not falling within the first category and in which more than one taxable year of the acquiring corporation is, by reason of the last sentence of section 742 (a), considered to begin in a base period year. Since such taxable years include taxable years of component corporations, a group excess profits net income or group deficit in excess profits net income, as the case may be, is determined for 12 months, in a manner similar to that in the first category above. However, in this second category not all of such components' first taxable years in the base period year begin on the same day as the acquiring corporation's first taxable year in such base period year, as in cases in the first category, and, therefore, the following adjustments are prescribed:

Daily average method. Before applying the daily average method as in the first category, it is necessary in cases falling within this second category to develop conditions equivalent to those existing in the first category by adjusting the experience of any such components to a period beginning on the same day as the beginning of the acquiring corporation's first taxable year in such base period year. This development and the adjustment to be made in this category under the daily average method are shown in the following examples:

Example (1). The A Corporation, which computed its income tax on the calendar year basis, was reorganized on July 1, 1936, in a Supplement A transaction into the B Corporation, which thereafter computed its income tax on a fiscal year basis beginning July 1 (until 1940, when it changed to a calendar year basis). The C Corporation which computed its income tax on a fiscal year basis beginning March 1 was in existence prior to 1936. The B Corporation acquired all of the assets of C in a Supplement A transaction on October 31, 1936. The excess profits net incomes (or deficits) of A and C for such of their taxable years in 1936 as begin before July 1, 1936, are to be adjusted to the period beginning July 1, 1936. Thus, the excess profits net income (or deficit) of A for the period of January 1, 1936–July 1, 1936, is to be divided by 182 (the number of days in the period January 1, 1936–July 1, 1936, inclusive) and the resulting quotient is to be multiplied by 1 (the number of days in the period beginning July 1 and in such taxable year of A beginning before July 1). The excess profits net income (or deficit) of C for the period March 1, 1936–October 31, 1936, is to be placed on the basis of the period July 1, 1936–October 31, 1936. Thus, if the excess profits net income of C for the period March 1, 1936–October 31, 1936, is $49,000, such amount when adjusted will be $24,600, computed by dividing $49,000 by 245 (the number of days in the period March 1, 1936–October 31, 1936, inclusive) and by multiplying the resulting quotient of $200 by 123 (the number of days in the period July 1, 1936–October 31, 1936, inclusive). The amount of $24,600 is to be added to the amounts of excess profits net incomes (or deficits) of the A Corporation, as previously adjusted to the basis of 1 day, and of the B Corporation for the period July 1, 1936–June 30, 1937. No further adjustment is necessary in this case because the resulting sum is the excess profits net income of the acquiring corporation, B (including A and C), for a period of 12 months which is to be attributed to the base period year 1936.

Example (2). The D Corporation computes its income tax on a fiscal year basis beginning March 1. In 1937, it changed to a fiscal year beginning July 1 (which it continued to use until 1940 when it changed to a calendar year basis). D acquired the assets of corporations in Supplement A transactions as follows: the E Corporation, August 1, 1937; the F Corporation, December 31, 1937; and the G Corporation, May 31, 1938. Assume that the excess profits net incomes or deficits in excess profits net income for the pertinent periods are as follows (the first date at the left indicating the beginning of a taxable year):

D: March 1, 1937–June 30, 1937	$12,200
D: July 1, 1937–June 30, 1938	54,700
E: February 1, 1937–August 1, 1937	18,200
F: April 1, 1937–December 31, 1937 (deficit)	27,500
G: May 1, 1937–April 30, 1938	36,500
G: May 1, 1938–May 31, 1938	3,100

The first day of the first taxable year of the acquiring corporation, D, beginning in 1937 is March 1, 1937. Therefore, the excess profits net income of the E Corporation for its taxable year beginning prior to such date (i. e., beginning on February 1, 1937) must be adjusted to a period beginning on March 1, 1937. The deficit in excess profits net income of the F Corporation for its taxable year beginning after such date (i. e., on April 1, 1937) must be adjusted to the period beginning March 1, 1937. Similarly, the first taxable year of the G Corporation to be taken into account begins after March 1, 1937 (i. e., on May 1, 1937) and, therefore, the excess profits net income for such year must be adjusted to the period beginning March 1, 1937. The following computations result:

E: Excess profits net income for taxable period February 1, 1937–August 1, 1937	$18,200
Divided by number of days in period ($18,200÷182)	100
Multiplied by number of days in period March 1, 1937–August 1, 1937 (154×$100)	15,400
F: Deficit in excess profits net income for taxable period April 1, 1937–December 31, 1937 (deficit)	27,500
Divided by number of days in period ($27,500÷275) (deficit)	100
Multiplied by number of days in period March 1, 1937–December 31, 1937 (306×$100) (deficit)	30,600
G: Excess profits net income for taxable period May 1, 1937–April 30, 1938	36,500
Divided by number of days in period ($36,500÷365)	100
Multiplied by number of days in period March 1, 1937–April 30, 1938 (426×$100)	42,600

The excess profits net income of the taxpayer for 1937 therefore will be $73,000, computed in the same manner as in the first category, as follows:

(1) Excess profits net incomes for taxable years beginning in 1937 (the first taxable year in each case beginning on the same day, March 1, 1937):	
D Corporation ($12,200+$54,700)	$66,900
E Corporation	15,400
G Corporation ($42,600+$3,100)	45,700

Total	$128,000
(2) Deficit in excess profits net income for taxable year beginning in 1937: F Corporation (March 1, 1937–December 31, 1937)----(deficit)	80,600
(3) Excess of aggregate excess profits net incomes over deficit in excess profits net income	97,400
(4) Amount in (3) divided by number of days in total period (March 1, 1937–June 30, 1938) ($97,400÷487)	200
(5) Amount in (4) multiplied by number of days in 1937 ($200×365)	73,000

Actual experience method. Under this method, the actual excess profits net income (or deficit) of the corporations falling within this category for the period of 12 months beginning with the first day of the first taxable year in such base period year of the acquiring corporation shall be considered the total (or group) excess profits net income (or deficit) of such corporations for all their taxable years beginning in such base period year. If such 12-month period ends after May 31, 1940, or with or after a month in which a Supplement A transaction occurs in a taxable year of the acquiring corporation not beginning in such base period year, the experience after such date or for and after such month, whichever first occurs, shall not be used. In such case, there shall be added to the experience used the experience for as many consecutive months immediately preceding the beginning of the period of months used as will produce an aggregate period of 12 months.

The first rule in this category under the actual experience method may be illustrated by example (1) above in this category, where, under the actual experience method, the total (or group) excess profits net income (or deficit) of the A, B, and C Corporations, for the base period year 1936, would be determined from their actual experience for the 12-month period beginning with July 1, 1936. It will be noted that under this rule no excess profits net income is included with respect to A for the period January 1, 1936–June 30, 1936, or with respect to C for the period March 1, 1936–June 30, 1936. The same rule may be applied similarly to example (2) above in this category.

(4) *Application for use of actual experience method.* If the taxpayer desires to use the actual experience method for any base period year, as prescribed in this paragraph, it shall file with its return or claim in which it determines its excess profits tax under the provisions of Supplement A a statement showing the computations of its total (or group) excess profits net income (or deficit) for the taxable years in each of such base period years, together with such explanation as it believes necessary to establish that the total (or group) excess profits net income under this method more clearly reflects actual group excess profits net income (or deficit) for such base period years than does the daily average method. If the total (or group) excess profits net income for any such base period year is finally determined under the actual experience method, or if permission is granted by the Commissioner before a final determination by the Commissioner, the taxpayer, in computing its excess profits tax under Supplement A in any return required to be filed thereafter, may, without the filing of such statement but with reference to the statement as to which the final determination had been made or permission given, use such total (or group) excess profits net income, except as further adjustment may be necessary in the case of the taxpayer under the rules of section 711 (b) (1) (K) (iii).

(b) *Limitation under section 742 (f) (1) in case of stock acquisition.* Section 742 (f) (1) is designed to prevent certain duplications in base period income and transferred capital additions and reductions in certain cases where after December 31, 1935, assets of the taxpayer (or of a corporation which later becomes its component) are transferred for stock in another corporation which later becomes a component of the taxpayer. Section 742 (f) (1) contemplates that, after the Supplement A transaction, the part of the component's base period experience which is attributable to the acquired stock and which occurred before the acquisition of its stock shall under regulations prescribed herein be excluded in determining the taxpayer's Supplement A average base period net income. The adjustment under section 742 (f) (1) shall be made in the cases described in this paragraph, and in all other cases to which section 742 (f) (1) may be applicable, in a manner consistent with the principles underlying such described cases. Except to the extent duplication of experience occurs, no adjustment is necessary under section 742 (f) (1) with respect to stock which the acquiring corporation acquired directly from the corporation whose stock was acquired.

The rules for the application of section 742 (f) (1) for the purpose of computing Supplement A average base period net income under the general average method and under the growth formula (see § 35.742–2) are set forth in this paragraph. As to determination of excess profits net income for such purpose under the limitations of section 742 (f) (1) for any "vacant" base period year, see § 35.742–4. As to adjustment of daily capital addition or reduction in case of such stock acquisition prior to the Supplement A transaction, see § 35.743–1 (b).

The general application of section 742 (f) (1) may be illustrated by the following examples:

Example (1). The A and B Corporations were in existence on January 1, 1936, and have at all times made their income tax returns on the calendar year basis. On January 1, 1937, A purchased for cash all of the stock in B from the stockholders of B. On December 31, 1939, A acquired all of the assets of B in a Supplement A transaction. In determining A's Supplement A average base period net income, the excess profits net income of A for 1936, 1937, 1938, and 1939 and of B for 1937, 1938, and 1939 will be included, and that of B for 1936 will be excluded.

Example (2). The C and D Corporations were in existence on January 1, 1936, and have at all times made their income tax returns on the calendar year basis. On January 1, 1941, C acquired for cash all of D's stock from D's stockholders. On December 31, 1941, C acquired all of the assets of D in a Supplement A transaction. In such a case, section 742 (f) (1) requires the exclusion of D's entire base period experience in computing C's Supplement A average base period net income. (D's capital additions and reductions in 1940 are also required to be excluded. See § 35.743–1 (b).)

In cases in which the taxpayer does not at one time or at any time prior to the Supplement A transaction acquire all of the other corporation's stock, only that part of the component's base period experience before the acquisition which is attributable to the stock so acquired is to be excluded in computing the taxpayer's Supplement A average base period net income. In cases in which the component had only one class of stock outstanding at the time of the Supplement A transaction, the portion of the component's experience to be excluded under section 742 (f) (1) with respect to any part of the base period is an amount which bears the same ratio to the whole of the component's experience for such part as the number of shares of such stock acquired by the taxpayer after such part, and not disposed of prior to the Supplement A transaction, bears to the aggregate number of such shares outstanding at the time of the acquisition of such stock. If any of such shares of stock, whether acquired before or after the beginning of the base period, were disposed of prior to the Supplement A transaction, the shares disposed of shall, for the purpose of this computation, be deemed to be those most recently acquired. The adjustment under section 742 (f) (1) in cases described in this paragraph may be illustrated by the following examples:

Example (1). The E and F Corporations were in existence on January 1, 1936, and have at all times made their income tax returns on the calendar year basis. The outstanding capital stock of F consists of 1,000 shares, all of one class. On January 1, 1937, E purchased for cash 510 shares of such stock from the stockholders of F. On December 31, 1941, E issued stock in exchange for the balance of the stock of F and acquired all of the assets of F in a Supplement A transaction. For the purpose of computing E's Supplement A average base period net income for the tax for 1942 and thereafter, 51 percent of F's excess profits net income or deficit in excess profits net income for 1936 is to be excluded under section 742 (f) (1).

Example (2). Assume the same facts as in example (1) just above and the additional fact that on January 1, 1938, E purchased for cash 340 additional shares of F from the stockholders of the latter, making its total stock holdings in F 850 shares prior to the issuance of its (E's) own stock for the balance of the stock of F and prior to the Supplement A transaction. In such case, there shall be excluded under section 742 (f) (1) an amount equal to 85 percent (51 percent plus 34 percent) of F's excess profits net income, or deficit, for 1936 and 34 percent of its excess profits net income, or deficit, for 1937.

Example (3). Assume the same facts as in example (2) just above and the additional fact that on January 1, 1939, E sold 350 shares of the F Corporation stock to various individuals. Accordingly, immediately prior to the issuance of its (E's) own stock for the balance of the stock of F and prior to the

Supplement A transaction, E will own 500 shares of the stock of F acquired for assets since December 31, 1935. Therefore, 50 percent of F's excess profits net income, or deficit, for 1936 will be excluded under section 742 (f) (1). No portion of such experience for 1937, 1938, or 1939 will be excluded since the 350 shares sold are presumed to include all of the 340 shares acquired on January 1, 1938 (as in example (2)), and only 10 shares of the 510 shares acquired on January 1, 1937.

Example (4). Assume the same facts as in examples (1), (2), and (3), except that the original acquisition of 510 shares of F's stock occurred prior to January 1, 1936. In such case, no adjustment will be necessary under section 742 (f) (1) because the 350 shares disposed of on January 1, 1939, are deemed to be out of the most recently acquired shares, including in this case all of the shares acquired since December 31, 1935, that is, the 340 shares acquired on January 1, 1938.

Where the corporation whose stock is acquired has at the time of such acquisition more than one class of stock outstanding and the taxpayer does not, prior to the Supplement A transaction, acquire all of the stock of all classes for assets (other than its own stock), the base period experience of the component which is to be excluded under section 742 (f) (1) must be determined upon the basis of the earnings which may be attributed to each class of stock. Where preferred stock is nonvoting and is also limited and preferred as to dividends, the base period excess profits net income may be allocated first to the preferred stock on the basis of the prescribed dividend rate per share. If the only other class is common stock, the balance of such excess profits net income may be allocated to the common stock. The portion of such base period excess profits net income which is attributable to the stock owned by the acquiring corporation is that portion of such base period excess profits net income allocated to the class to which such stock belongs proportionate to the number of shares of such class acquired by the acquiring corporation after December 31, 1935. This rule may be illustrated by the following example:

Example. The G Corporation was in existence on January 1, 1936, and has at all times made its income tax returns on the calendar year basis. It has had outstanding at all times the following shares:

5,000 shares of nonvoting preferred stock of a par value of $100 per share, limited and preferred as to dividends to the extent of $6 per share annually.

10,000 shares of no-par-value common stock possessing sole voting power.

On January 1, 1938, the H Corporation acquired for cash 6,000 shares of G's common stock from the stockholders of G. The excess profits net income of G for 1936 and 1937 was $100,000 each year. Of this amount, $30,000, representing the prescribed dividend rate of $6 a share on 5,000 shares, is allocable to the preferred stock. Of the balance of $70,000 which is allocable to the common stock, 60 percent (the ratio of the 6,000 shares of common stock acquired by H since December 31, 1935, to the total of 10,000 shares of such stock outstanding), or $42,000, will be considered attributable to the stock so acquired by H. Therefore, if H subsequently acquired all of the assets of G in a Supplement A transaction (no stock of G having been purchased or disposed of in the interval), $42,000 of G's excess profits net income for 1936 and 1937 is to be excluded under section 742 (f) (1) in computing the Supplement A average base period net income of H. If G had a deficit in excess profits net income for either 1936 or 1937, or for both, such deficit would be considered attributable solely to the common stock for purposes of determining the portion to be excluded under section 742 (f) (1).

The acquisition of stock by the acquiring corporation may occur on a day in a taxable year of the acquiring corporation other than the first day of such year, as in the cases previously discussed in this subdivision. If such stock acquisition occurred in a taxable year of the acquiring corporation beginning in a base period year, the amount of the component's excess profits net income (or deficit) for its taxable year or years beginning in such base period year to be excluded shall be determined upon the basis of the ratio which the number of days in such acquiring corporation's taxable year or years up to the date of such stock acquisition bears to the total number of days in such acquiring corporation's taxable year or years. If the stock acquisition occurred in an excess profits tax taxable year for which the tax is being computed and later in such year the Supplement A transaction occurred, the amount of the component's base period experience to be excluded under section 742 (f) (1) shall be determined upon the basis of the ratio which the number of days in such excess profits tax taxable year of the acquiring corporation up to the date of such stock acquisition bears to the total number of days in such year. This rule may be illustrated by the following examples (in which it is assumed that the base period years are calendar years):

Example (1). The J Corporation purchased for cash all of the stock of the K Corporation from the latter's stockholders on July 2 1936, and on December 31, 1942, acquired the assets of the K Corporation in a Supplement A transaction. The J Corporation made its income tax returns on the calendar year basis.

(i) If the K Corporation made its income tax returns on the calendar year basis, one-half of K's excess profits net income or deficit in excess profits net income (the ratio which the number of days in the period January 1 through July 1, 1936 (183 days), bears to the total number of days in 1936 (366) is to be excluded under section 742 (f) (1) in computing J's Supplement A average base period net income.

(ii) If the K Corporation made its income tax returns on the basis of a fiscal year ending July 31, the excess profits net income or deficit in excess profits net income of K for the fiscal year ending July 31, 1937, would otherwise be includible in the group excess profits net income (or deficit) for 1936. Although the stock acquisition occurred before the beginning of such taxable year of K (but after December 31, 1935), nevertheless one-half of such experience of K for its taxable year ended July 31, 1937, is to be excluded under section 742 (f) (1).

(iii) If the K Corporation had made its income tax returns on the basis of the fiscal year ending July 31, and then received permission to make its income tax returns on the calendar year basis after the close of its taxable year ending July 31, 1936, K has a short taxable year in 1936 for the period August 1 through December 31, 1936. The excess profits net income or deficit in excess profits net income for such short taxable year is to be adjusted to represent 12 months' experience, as provided in paragraph (a) of this section, and of the amount thus determined, one-half is to be excluded under section 742 (f) (1) in computing the group excess profits net income (or deficit) for 1936.

(iv) If the K Corporation had made its income tax returns on a calendar year basis and then received permission to make such returns on the basis of a fiscal year beginning August 1, 1936, the experience for the two taxable years, January 1, 1936, through July 31, 1936, and August 1, 1936, through July 31, 1937, are to be adjusted to represent 12 months' experience, as provided in paragraph (a) of this section. Of the amount thus determined, one-half is to be excluded under section 742 (f) (1) in computing the group excess profits net income (or deficit) for 1936.

Example (2). Assume the same facts as in example (1) (including the variations in (i), (ii), (iii), and (iv) thereof) except that J, the acquiring corporation, received permission to make its income tax returns on a fiscal year basis beginning May 1, 1936, and filed its returns on such basis until 1940 when it changed back to a calendar year basis, and that J purchased for cash all of the stock of K from the latter's stockholders on August 31, 1936 (instead of July 2, 1936, as in example (1)). In such case, J has two taxable years beginning in 1936, the taxable year January 1, 1936–April 30, 1936, and the taxable year May 1, 1936–April 30, 1937. The excess profits net income (or deficit) for such two taxable years is to be placed on an annual basis as provided in paragraph (a) of this section. Nevertheless, one-half of the experience of the K Corporation is to be eliminated in computing group excess profits net income for 1936, just as in example (1). This is determined from the ratio of the number of days in such taxable years prior to August 31, 1936 (243, the number of days in the period January 1, 1936–August 30, 1936), to the total number of days in both taxable years (486, the number of days in the period January 1, 1936–April 30, 1937).

Example (3). The L Corporation which makes its income tax returns on the calendar year basis, on March 2, 1944, purchases for cash all of the stock of the M Corporation from the stockholders of M. On July 2, 1944, L acquires all of the assets of M in a Supplement A transaction. In such case, one-sixth (the ratio of the number of days in the period January 1, 1941–March 1, 1944, 61 days, to the total number of days in 1944, 366 (days) of M's experience for each base period year is to be eliminated under section 742 (f) (1) in computing the Supplement A average base period net income of L for the purpose of the excess profits credit to be applied in computing the tax for 1944. For further limitation upon the average base period net income computed after this limitation, see section 742 (f) (2) and paragraph (c) of this section. In computing the Supplement A average base period net income of L for the purpose of the tax for 1945, the entire base period experience of M is to be eliminated. As to limitations upon the use of M's capital additions and reductions, see § 35.743–1 (b).

Section 742 (f) (1) does not apply where stock of one corporation is acquired by another corporation solely in exchange for the latter's stock. In case stock is acquired in exchange partly for the acquiring corporation's own stock and partly for other property, section 742 (f) (1) is applicable only to the extent that the acquisition is attributable to such other property. Stock which has, in the hands of the taxpayer, a basis determined with reference to the basis of stock previously acquired by the issuance of the taxpayer's own stock shall be considered as having been acquired in consideration of the issuance of the

taxpayer's own stock. These rules may be illustrated by the following examples:

Example (1). Corporation N acquires, after December 31, 1935, stock in Corporation O in exchange solely for the stock of N. In a subsequent nontaxable reorganization, N receives new shares of O in exchange for the original shares. If the new shares take the basis of the original shares, the new shares are considered, for the purposes of section 742 (f) (1), to have been acquired for the stock of N, and such section is inapplicable.

Example (2). The P and Q Corporations were in existence prior to January 1, 1936. On January 1, 1937, P acquired all the stock of Q from the latter's stockholders, in exchange for stock of P. On January 1, 1938, in a nontaxable reorganization, the X Corporation was organized and acquired all the assets of Q in exchange for its (X's) stock. In connection with this reorganization, P exchanged its stock in Q for the stock in X, and Q was dissolved. On December 31, 1939, P acquired all the assets of X in a Supplement A transaction. For the purposes of section 742 (f) (1), the stock in X acquired by P is regarded as having been acquired for its own stock and, therefore, no adjustment is required under section 742 (f) (1).

Section 742 (f) (1) also applies in cases in which a component (referred to as the "first corporation") of the taxpayer transfers assets for the stock in a corporation (referred to as the "second corporation") and both corporations become components of the taxpayer (the second corporation becoming a component either directly or as a component of the first corporation). The statute also applies to any other corporation which becomes a component of the taxpayer and which at the time of a stock acquisition by the taxpayer or first corporation (under the circumstances described in section 742 (f) (1) (A) or (B)) was connected, directly or indirectly, through stock ownership with the corporation the stock of which was acquired. In the case of such a corporation connected through stock ownership, the statute applies regardless of the manner of acquisition of the stock of such connected corporation held at such time (for example, whether or not acquired for a consideration other than the issuance of stock). The statute also applies regardless of the date before such time that the corporation holding such stock, directly or indirectly, acquired such stock of such connected corporation. That is, it is immaterial whether the stock of such connected corporation held at such time was acquired before, on, or after December 31, 1935, as long as such stock was acquired before the time the acquisition of stock of the corporation to which it was so connected occurred in a transaction described in section 742 (f) (1) (A) or (B). In the case of any such corporation connected through stock ownership at such time, the amount of its excess profits net income, or deficit, which is to be eliminated under section 742 (f) (1) is to be determined by reference to that part of such amount which is attributable to the period prior to such time and which is attributable to the stock held, directly or indirectly, at such time, and not disposed of thereafter, by the corporation the stock of which was acquired at such time by the taxpayer or first corporation. Such experience to be eliminated is to be attributed to the period prior to such time and to such stock so held upon the basis of the principles previously stated in this subsection. To the extent that the stock of a corporation (later to become a component) was not so held at such time but was subsequently acquired, after December 31, 1935, by the taxpayer or another corporation (a first or second corporation), for assets of the latter, the base period experience of such corporation is to be excluded in accordance with the rules previously set forth in this subsection for excluding the experience of a component when the latter's stock is acquired after December 31, 1935, for assets by the taxpayer. The application of these rules in such cases is illustrated by the following examples:

Example (1). The R, S, T, and U Corporations were in existence prior to January 1, 1936, and at all times made their income tax returns on the calendar year basis. The S Corporation came into existence on January 1, 1935, and issued all of its stock to the stockholders of the T Corporation for the stock of the latter. On January 1, 1937, the S Corporation purchased for cash all of the stock of the U Corporation from stockholders of the U Corporation. On January 1, 1938, the R Corporation purchased for cash all of the stock of S from the latter's stockholders. On December 31, 1939, S acquired all of the assets of the T and U Corporations in Supplement A transactions. On December 31, 1940, R acquired all of the assets of S in a Supplement A transaction. In computing the Supplement A average base period net income of R, there is to be excluded under section 742 (f) (1) the experience of S, T, and U for 1936 and 1937.

Example (2). Assume the same facts as in example (1) above except that the S Corporation made the acquisition of the U Corporation's stock on January 1, 1939 (after the acquisition by R of the stock of S). In such case, there is to be excluded under section 742 (f) (1) the experience of both S and T for 1936 and 1937 and the experience of U for 1936, 1937, and 1938.

Example (3). The W, X, Y, and Z Corporations were all in existence in 1935 and at all times made their income tax returns on the calendar year basis. In July, 1935, the X Corporation acquired 50 percent of the stock of Y from the stockholders of the latter. On January 1, 1937, the W Corporation acquired for assets (other than its own stock) all of the stock of the X Corporation from the latter's stockholders. On January 1, 1938, the X Corporation acquired for assets (other than its own stock) the remaining 50 percent of the stock of the Y Corporation from other stockholders of the latter. On January 1, 1939, the Y Corporation acquired for assets (other than its own stock) all of the stock of the Z Corporation from the latter's stockholders. On January 31, 1939, the X Corporation acquired all of the assets of the Y Corporation in a Supplement A transaction and on November 30, 1939, the W Corporation acquired all of the assets of the X Corporation in a Supplement A transaction. On December 31, 1939, the W Corporation acquired all of the assets of the Z Corporation in a Supplement A transaction. In computing the Supplement A average base period net income of the W Corporation, there is to be excluded all of the experience of the X Corporation for 1936. There is also to be excluded all of the experience of the Y Corporation for 1936, one half of such experience being excluded because of the 50 percent ownership of its stock by the X Corporation at the time the stock of X was acquired by W and the other half being excluded because of the subsequent acquisition of the other 50 percent of the stock of Y by the X Corporation for the assets of the latter. One-half of the experience of the Y Corporation for 1937 is also to be excluded because of the acquisition of one-half of its stock on January 1, 1938, by the X Corporation for assets of the latter. The entire experience of the Z Corporation for 1936, 1937, and 1938 is to be excluded because of the acquisition from the stockholders of Z on January 1, 1939, of the stock of Z for assets of the Y Corporation.

(c) *Limitation under section 742 (f) (2) in case of Supplement A transaction in excess profits tax taxable year.* Section 742 (f) (2) imposes a limitation in case a corporation becomes an acquiring corporation in an excess profits tax taxable year. In such case only a proportionate amount of the excess profits net income or deficit in excess profits net income of any component corporation acquired upon such transaction may be included in computing the taxpayer's average base period net income for purposes of the excess profits credit for such taxable year. The amount thereof which may be included with respect to each base period year is an amount which bears the same ratio to the total amount of the excess profits net income or deficit in excess profits net income of such component corporation otherwise includible in such base period year as the number of the days in the taxable year after the acquisition takes place bears to the total number of days in the taxable year. In the computation of the excess profits credit based on income for subsequent taxable years, the average base period net income shall, unless otherwise limited, reflect the full amount of the base period excess profits net income or deficit in excess profits net income of such component corporation. Section 742 (f) (2) may be illustrated by the following example:

Example. On October 19, 1942, the X Corporation acquires all of the assets of the Y Corporation in a transaction described in section 740 (a). Both the X Corporation and the Y Corporation were in existence on January 1, 1936, and both corporations have always filed their income tax returns on the calendar year basis. The Y Corporation had an excess profits net income of $100,000 for the calendar year 1936, a deficit in excess profits net income of $10,000 for the calendar year 1937, an excess profits net income of $70,000 for the calendar year 1938, and an excess profits net income of $50,000 for the calendar year 1939. In computing its average base period net income for purposes of the excess profits credit for the calendar year 1942, the X Corporation may include only one-fifth (i. e., 73/365) of the above amounts, i. e., $20,000 for 1936, minus $2,000 for 1937, $14,000 for 1938, and $10,000 for 1939. In computing the excess profits credit for 1943 and subsequent years, however, the X Corporation may include the full amount of the base period excess profits net income and deficit in excess profits net income of the Y Corporation.

A similar limitation applies in the case of a component corporation for the purpose of computing its excess profits credit for a taxable year of such component beginning after December 31, 1941, and in which the Supplement A transaction occurs. See section 740 (c) (2). In such

case, however, the proportionate amount of the average base period net income or Supplement A average base period net income, as the case may be, to be taken into account for the purpose of the component corporation's excess profits credit for such taxable year is in the ratio which the number of days in such taxable year before the day after the transaction bears to the total number of days in such taxable year. Thus, in the above example, in computing the average base period net income or the Supplement A average base period net income, as the case may be, of the Y Corporation (assuming it continues in existence after the transaction) for the purpose of its excess profits credit for 1942, the amounts to be taken into account will be $80,000 for 1936, minus $8,000 for 1937, $56,000 for 1938, and $40,000 for 1939.

§ 35.742–4 *Computation of excess profits net incomes for base period years during which neither taxpayer nor any component corporation was in existence; applicable under both general average method and increased earnings method*—(a) *General.* The base period of an acquiring corporation is composed of four successive 12-month periods, whether or not there is one or more of such base period years during the whole of which neither the acquiring corporation nor any of its component corporations was in existence (although, of course, either the acquiring corporation or one of its components must have been actually in existence prior to January 1, 1940, in order for Supplement A to apply). Section 742 (e) (1) provides a method for determining the excess profits net incomes of the several corporations for a base period year during which none of such corporations was actually in existence.

In the case of an acquiring corporation which acquired the assets of its component corporation in a Supplement A transaction occurring before the beginning of such acquiring corporation's last taxable year which began in 1939, the following steps are required for the computation of its excess profits net income for a base period year during which neither the acquiring corporation nor the component corporation was at any time in existence:

(1) The daily invested capital of the acquiring corporation for the first day of its first excess profits tax taxable year is determined.

(2) There is determined the percentage of such daily invested capital which would be applicable under section 720 in reduction of the average invested capital of the acquiring corporation on account of inadmissible assets for its last taxable year beginning in 1939, in the same manner as if section 720 had been applicable to such year.

(3) The amount determined under (1) is reduced by an amount equal to the same percentage of such daily invested capital as the percentage determined under (2).

(4) 8 percent of the amount found under (3) is determined.

The amount determined under (4) is the excess profits net income of the acquiring corporation for such base period year. In such case, no excess profits net income is to be built up for the component corporation for such base period year.

In the case of an acquiring corporation which acquired a component corporation in the acquiring corporation's last taxable year beginning in 1939, the excess profits net income of the acquiring corporation for a base period year during which neither of such corporations was at any time in existence is determined in the manner prescribed in the preceding paragraph, except that, in determining the percentage figure under section 742 (e) (1) (B), the acquiring corporation is considered to have held the admissible and inadmissible assets held by the component corporation (and at the time so held by it) immediately prior to the transaction and during any part of such taxable year of the acquiring corporation. In such case, no excess profits net income is to be built up for the component corporation for such base period year.

In case the Supplement A transaction by which a corporation became a component corporation of its acquiring corporation occurred in the last taxable year of such component corporation beginning in 1939 but on a day in a taxable year of such acquiring corporation beginning in 1940, the following steps are required for the computation of the excess profits net income with respect to such component corporation for a base period year during which neither of such corporations was at any time in existence:

(1) The daily invested capital of the component corporation for the day of the transaction is determined.

(2) There is determined the percentage of such daily invested capital which would be applicable under section 720 in reduction of the average invested capital of the component corporation on account of inadmissible assets for the 12-month period ending with the day preceding the day of the transaction, in the same manner as if such 12-month period constituted a taxable year and section 720 had been applicable to such taxable year.

(3) The amount determined under (1) is reduced by an amount equal to the same percentage of such daily invested capital as the percentage determined under (2).

(4) 8 percent of the amount found under (3) is determined.

The amount determined under (4) is the excess profits net income of the component corporation for such base period year.

In the case of an acquiring corporation which acquired all of the assets of a component corporation after the beginning of both corporation's first excess profits tax taxable year, the excess profits net income for each corporation for a base period year during which neither was at any time in existence is determined in the manner prescribed in the second paragraph of this subsection, the amount for the component being determined under such paragraph in the same manner as if it were an acquiring corporation.

The application of the foregoing rules under section 742 (e) (1) and (2) may be illustrated by the following examples (examples (1) and (2) covering subsection (e) (1) in general; example (3) dealing with the application of subsection (e) (1) (B), and example (4) covering subsection (e) (2)):

Example (1). The F Corporation, on the calendar year basis, was organized on January 1, 1937. The G Corporation was organized on December 1, 1936. It has at all times used a fiscal year ending November 30. On January 1, 1942, the F Corporation acquired the properties of G Corporation in a Supplement A transaction. Since the G Corporation was actually in existence in the base period year 1936, section 742 (e) (1) is not applicable and therefore the F Corporation will not be permitted to build up any income for 1936.

Example (2). The H Corporation and the J Corporation came into existence on January 1, 1937, and January 1, 1938, respectively. Both corporations have at all times been on the calendar year basis. On January 1, 1942, the H Corporation acquired all of the assets of the J Corporation in a Supplement A transaction. Although the J Corporation was not actually in existence in 1937, the H Corporation was actually in existence in such year. Therefore, no excess profits net income may be built up with respect to such year. However, since neither corporation was actually in existence in 1936, income may be built up for such year. Such income is the excess profits net income built up for each corporation for 1936. In the case of each corporation the built up income is an amount equal to 8 percent of the excess of:

(i) The daily invested capital of the corporation for January 1, 1940, over

(ii) An amount which is the same percentage of such capital as the percentage determined as provided in section 742 (e) (1) (B) under the rules of section 720 by reference to its last taxable year beginning in 1939.

Example (3). The M Corporation came into existence on November 1, 1937. It has at all times used a fiscal year ending October 31. The N Corporation, on the calendar year basis, came into existence on January 1, 1937. On October 1, 1940, the M Corporation acquired all of the assets of the N Corporation in a Supplement A transaction. Here the date of the transaction fell within the M Corporation's last taxable year beginning within 1939, but within the N Corporation's first excess profits tax taxable year. In building up excess profits net income for 1936 (the year in which neither corporation was in existence), there is taken into account only the M Corporation's daily invested capital—for November 1, 1940. The N Corporation's daily invested capital is reflected in the M Corporation's daily invested capital for such day. In determining the percentage figure as provided in section 742 (e) (1) (B) under the rules of section 720 by reference to its taxable year ended October 31, 1942 (to be used in reducing the M Corporation's daily invested capital), the M Corporation is treated as if it had held the admissible and inadmissible assets which the N Corporation held during the period November 1, 1939, through September 30, 1940.

Example (4). The K Corporation, on the calendar year basis, came into existence on January 1, 1937. The L Corporation was organized on July 1, 1937. It has at all times used a fiscal year ending June 30. On March 1, 1940, the K Corporation acquired all of the assets of the L Corporation in a Supplement A transaction. The date of the transaction fell, accordingly, within the K Corporation's first excess profits tax taxable

year, but within the L Corporation's last taxable year beginning in 1939. In building up excess profits net income for each corporation for 1936 (the year in which neither corporation was in existence), there is taken into account the K Corporation's daily invested capital for January 1, 1940, and the L Corporation's daily invested capital for March 1, 1940.

(b) *Limitations.* The determination of excess profits net income for vacant base period years is subject to each of the following limitations:

(1) Section 742 (e) (3) acts as a limitation on subsections (e) (1) and (2). The cases generally covered by it are those in which there was cross-ownership of stock between such corporations prior to the Supplement A transaction, but it also covers cases where property or stock of either corporation has been transferred to the other as paid-in surplus or as a contribution to capital. As such, the primary purpose of section 742 (e) (3) is to prevent doubling up on the factor of the daily invested capital carried into the first excess profits tax taxable year as the factor upon which the constructive income allowed under subsections (e) (1) and (2) is computed.

Briefly stated, section 742 (e) (3) provides that in case any corporation described in section 742 (e) (1) owned stock in any other such corporation on the first day of such owning corporation's first excess profits tax taxable year beginning in 1940, then the invested capital factor, upon which the constructive income allowed under section 742 (e) (1) and (2) with respect to such corporations is computed, shall be adjusted to such extent as may be necessary to prevent such constructive income from reflecting money or property paid in by either of such corporations to the other for stock or as paid-in surplus or as a contribution to capital; or from reflecting stock of either paid in for stock of the other or as paid-in surplus or as a contribution to capital. For this purpose, stock in either such corporation which has in the hands of the other corporation a basis determined with reference to the basis of stock previously acquired by the issuance of such other corporation's own stock shall be deemed to have been paid in for the stock of such other corporation. For certain limitations in other cases of cross-ownership of stock not covered by section 742 (e) (3), see section 742 (f) (1) and § 35.742–3 (b).

The following example illustrates the nature of the adjustment to be made in cases to which section 742 (e) (3) applies:

Example. The O Corporation and the P Corporation are both on the calendar year basis. The O Corporation came into existence on January 1, 1938. The P Corporation was organized on December 31, 1938, and on that date it issued all of its capital stock to the O corporation in exchange for assets of the latter. The O Corporation holds this stock continuously until December 31, 1941, at which time it acquires the P Corporation in a transaction described in section 740 (a) (2). Each corporation is entitled under section 742 (e) (1) to a constructive income for the years 1936 and 1937. This constructive income is computed at 8 percent of the excess of its daily invested capital for January 1, 1940, over an amount which is the same percentage of such invested capital as the percentage determined under section 720—generally known as the inadmissible asset ratio. In the event that the reduction under section 720 in the O Corporation's daily invested capital for January 1, 1940, attributable to the stock in P is an amount which is less than the basis of such stock to the O Corporation, a further adjustment shall be made in its invested capital in order to eliminate duplication of the same invested capital. Assuming that the basis of the P stock to the O Corporation under section 718 (a) (2) is $50,000; that on December 31, 1938, and December 31, 1939, it owned shares in other domestic corporations having a basis of $10,000; and that the O Corporation's daily invested capital for January 1, 1940, is $450,000 (section 742 (e) (1) (A)), the computation of the adjustment required under section 742 (e) (3) may be illustrated as follows:

(i) Total inadmissible assets (based upon computation under section 720)		$60,000
(ii) Total admissible and inadmissible assets computed under section 720 with reference to the aggregate of both classes of assets (§ 35.720–1)		600,000
(iii) Percentage which the total inadmissible assets is of total admissible and inadmissible assets	percent	10
(iv) Daily invested capital of the O Corporation for January 1, 1940, as stated above		450,000
(v) Amount of reduction in the O Corporation's daily invested capital for January 1, 1940, for inadmissible assets under section 742 (e) (1) (B)—10 percent of item (iv)		45,000
(vi) Reduction in the daily invested capital of the O Corporation for January 1, 1940, which is attributable to the stock in the P Corporation $\left(\frac{50,000}{60,000} \times 45,000\right)$		37,500
(vii) Basis of the P Corporation stock to the O Corporation		50,000
(viii) Adjustment to be made in the O Corporation's daily invested capital for January 1, 1940, in order to arrive at the invested capital factor under section 742(e)(3) upon which constructive income is computed		12,500
(ix) Daily invested capital for January 1, 1940		450,000
Adjustment for inadmissibles under section 720 (item (vi) above)	$45,000	
Adjustment under section 742(e)(3)	12,500	
		57,500
(x) Invested capital as adjusted under section 742(e)(3) upon which constructive income of the O Corporation is computed		392,500

(2) Section 742(f)(1) requires the exclusion from Supplement A average base period net income of all or a part of the base period experience of a component which is determined under section 742(e) for vacant base period years, if the taxpayer (or any corporation which later became a component of the taxpayer) acquired for assets (other than its own stock) the stock of such component after such vacant base period year. See § 35.742–3(b).

The adjustment necessary under section 742(f)(1) where excess profits net income for vacant base period years would otherwise be determined under section 742(e) is illustrated by the following example:

Example. The A and B Corporations were both organized on January 1, 1937, and have at all times made their income tax returns on the calendar year basis. On January 1, 1938, A purchased for cash all of the stock of B from the latter's stockholders. On December 31, 1940, A acquired all of the assets of B in a Supplement A transaction. Under section 742(e), the excess profits net incomes of A and B for 1936 are to be determined separately. However, by reason of section 742(f)(1), the experience of B prior to January 1, 1938, is to be excluded, and therefore no excess profits net income need be determined for B for 1936.

The application of section 742(f)(1) in other cases described in section 742(e) but not illustrated above is to be determined in accordance with the above principles and those of § 35.742–3(b).

SEC. 743. NET CAPITAL CHANGES. [Added by sec. 201, Second Rev. Act 1940; amended by sec. 4, Excess Profits Tax Amendments 1941, and by sec. 228 (d), Rev. Act 1942.]

(a) *Taxpayer using this supplement.* For the purposes of section 713 (g), if the transaction which constitutes the taxpayer an acquiring corporation occurs in a taxable year of the taxpayer which begins after December 31, 1939, and the taxpayer's average base period net income is computed under section 742, the following rules shall apply in computing the daily capital addition and reduction of the taxpayer for each day after such transaction:

(1) The transferred capital addition or reduction of the component corporation shall be treated as if it were a capital addition or reduction, as the case may be, of the taxpayer.

(2) The transferred capital addition of the component corporation shall be its daily capital addition as of the time immediately before the transaction (computed under section 713 (g), but without regard to its reduction under the fourth sentence of paragraph (3) on account of excluded capital, but with the application of paragraph (6) of this subsection).

(3) The transferred capital reduction of the component corporation shall be its daily capital reduction as of the time immediately before the transaction (computed under section 713 (g) but with the application of paragraph (7) of this subsection).

(4) In computing the daily capital addition of the taxpayer, money or property paid in to the taxpayer by any of its component corporations, and property consisting of stock in any such component corporation paid in by shareholders of such component corporation, shall be disregarded.

(5) In computing the daily capital reduction of the taxpayer, distributions by the taxpayer to any of its component corporations not out of earnings and profits shall be disregarded.

(6) In computing the transferred capital addition of the component corporation, money or property paid in to such component corporation by the taxpayer or any other component corporation and property consisting of stock in the taxpayer or any other component corporation paid in by shareholders of the taxpayer or other component corporation, shall be disregarded.

(7) In computing the transferred capital reduction of the component corporation, distributions by such component corporation

to the taxpayer or any other component corporation shall be disregarded.

(8) The daily capital addition of the taxpayer to which any amount is added under paragraph (1) shall be the amount thereof computed before its reduction under the fourth sentence of section 713 (g) (3) on account of excluded capital.

(b) *Rule where acquiring corporation is component of taxpayer.* In cases where an acquiring corporation is a component of the taxpayer, and the transaction which constitutes such corporation an acquiring corporation occurs in a taxable year of such corporation which begins after December 31, 1939, for the purpose of determining the daily capital addition or reduction of the taxpayer the above rules shall be applied in a similar manner to determine the daily capital addition or reduction of such acquiring corporation for each day after such transaction.

§ 35.743–1 *Net capital changes*—(a) *General.* If a taxpayer acquires a component corporation in a Supplement A transaction occurring in a taxable year of the taxpayer beginning after December 31, 1939, and if for the particular taxable year the taxpayer computes its average base period net income under section 742 for the purposes of its excess profits credit, the transferred capital addition of the component corporation is added to the taxpayer's daily capital addition for each day after such transaction and the transferred capital reduction of the component corporation is added to the daily capital reduction of the taxpayer for each such day.

The transferred capital addition of such component corporation is the daily capital addition of such component as of the time immediately before the transaction. Such daily capital addition is computed in accordance with the provisions of section 713 (g) except that it is not reduced on account of the excluded capital of the component corporation. In determining such daily capital addition of the component corporation, there is disregarded (1) money or property paid in to such component corporation by the taxpayer or any other component corporation of the taxpayer and (2) property consisting of stock in the taxpayer or any other component corporation of the taxpayer paid in by shareholders of the taxpayer or other component corporation.

The transferred capital reduction of such component corporation is the daily capital reduction of such component as of the time immediately before the transaction. Such daily capital reduction is computed in accordance with the provisions of section 713 (g). But in determining such daily capital reduction, there is disregarded distributions by such component corporation to the taxpayer or any other component corporation of the taxpayer.

The daily capital addition of the taxpayer to which the transferred capital addition of such component corporation is to be added is its daily capital addition computed in accordance with the provisions of section 713 (g), but before reduction on account of excluded capital. The taxpayer's excluded capital after the transaction, which is taken into account in making the reduction required by section 713 (g), will embrace the excluded capital of the component corporation which is carried over to the taxpayer in the transaction. In computing the daily capital addition of the taxpayer, there is disregarded (1) money or property paid in to the taxpayer by any of its component corporations and (2) property consisting of stock in any such component corporation paid in by the shareholders of that component corporation.

In computing the daily capital reduction of the taxpayer, there are disregarded distributions by the taxpayer to any of its component corporations not out of earnings and profits.

If an acquiring corporation is a component corporation of a taxpayer and if the transaction constituting such corporation an acquiring corporation occurred in a taxable year of such corporation beginning after December 31, 1939, then, for the purpose of determining the daily capital addition or reduction of the taxpayer, the provisions of this section shall be applied in a similar manner in order to determine the daily capital addition or reduction of such acquiring corporation for each day after such transaction.

This section may be illustrated by the following example:

Example. On March 1, 1942, the X Corporation, in exchange solely for its voting stock, acquires all the assets of the Y Corporation, having an adjusted basis for computing loss in the hands of the Y Corporation of $100,000. Immediately after the exchange, the Y Corporation distributes the stock of the X Corporation in complete liquidation. Both corporations make their income tax returns on a calendar year basis. Among the assets of the Y Corporation transferred in the Supplement A exchange were $30,000 of State bonds which it had purchased in 1938 for $32,000. The only money or other property paid into and distributions made by the Y Corporation from January 1, 1940, to March 1, 1942, were as follows:

January 15, 1942, $5,000 was paid into Y Corporation for stock by persons other than the X Corporation or any component thereof.

March 1, 1942, the day of the Supplement A transaction, but at a time prior to the transaction, the Y Corporation distributed $10,000 to shareholders (not including the X Corporation or any component thereof), of which only $7,000 was out of earnings and profits. If, for 1942, the X Corporation computes its average base period net income under Supplement A, it will have for March 2, 1942, and for each day thereafter, $5,000 of capital addition computed without regard to excluded capital, $32,000, of excluded capital (assuming the State bonds are retained for the balance of the year), and $3,000 of capital reduction. Such amounts will be added to the X Corporation's own capital additions, excluded capital, and capital reductions for 1942 in computing its capital additions and reductions under section 713 (g) for the purpose of its excess profits credit. No portion of the $100,000 paid in for stock on March 1, 1942, may be taken into account.

(b) *Limitation under section 742 (f) (1).* Section 742 (f) (1) requires the exclusion from transferred capital addition or reduction of any capital addition or reduction (determined as provided in section 743) of a component corporation attributable to stock of such component acquired for assets (other than its own stock) of the acquiring corporation before the Supplement A transaction. Necessarily this rule applies only in case the acquisition of such stock occurred on or after the beginning of the first excess profits tax taxable year of the component corporation, after such capital additions and reductions occurred, and before the Supplement A transaction. Such capital additions and reductions are to be attributed to such stock acquisitions in accordance with the principles of § 35.742–3 (b) and the purposes of section 742 (f) (1). No adjustment is necessary under section 742 (f) (1) with respect to stock which was acquired by the acquiring corporation directly from the corporation whose stock was acquired, unless duplication results and such duplication is not corrected under section 743.

SEC. 744. FOREIGN CORPORATIONS. [Added by sec. 201, Second Rev. Act 1940.]

The term "corporation" as used in this Supplement does not include a foreign corporation.

INVESTED CAPITAL IN CONNECTION WITH CERTAIN EXCHANGES AND LIQUIDATIONS [1]

SEC. 760. EXCHANGES. [Added by sec. 230 (a), Rev. Act 1942.]

(a) *Definitions, Etc.* For the purposes of this section—

(1) *"Exchange", "Transferor", and "Transferee".* The term "exchange" means a transaction by which one corporation (hereinafter called "transferee") receives property of another corporation (hereinafter called "transferor") and the basis of the property received, in the hands of the transferee, for the purposes of section 718 (a) is determined by reference to the basis in the hands of the transferor.

(2) *Determination of basis of property received.* The basis, in the hands of the transferee, of the property of the transferor received by the transferee upon the exchange shall be determined in accordance with section 718 (a).

(b) *Rule.* In the application of section 718 (a) to a transferee upon an exchange in determining the amount paid in for stock of the transferee, or as paid-in surplus or as a contribution to capital of the transferee, in connection with such exchange, only an amount shall be deemed to have been so paid in equal to the excess of the basis in the hands of the transferee of the property of the transferor received by the transferee upon the exchange over the sum of:

(1) The amount of any liability of the transferor assumed upon the exchange and of any liability subject to which such property was so received, plus

(2) The amount of any liability of the transferee (not arising out of any liability described in paragraph (1)) constituting consideration for the property so received, plus

(3) The aggregate of the amount of any money and the fair market value of any other property (other than such stock and other than property described in paragraphs (1) and (2)) transferred to the transferor.

(c) *Reduction in daily invested capital.* In the application of section 717 to a transferee upon an exchange, the daily invested capital for any day after such exchange shall be reduced by an amount equal to the amount by which the sum of the amounts specified in paragraphs (1), (2), and (3) of subsection (b) exceeds the basis in the hands

[1] Supplement C, sections 760–761 of the Internal Revenue Code. Supplement B, sections 750–752 not applicable to taxable years under these regulations (sec. 229, Rev. Act 1942).

of the transferee of the property of the transferor received upon the exchange.

§ 35.760–1 *Definitions and determinations.* For the purposes of section 760 and of §§ 35.760–1, 35.760–2, and 35.760–3:

(a) *Exchange, transferee, transferor.* The term "exchange" means a transaction in which one corporation, called the "transferee," acquires property of another corporation, called the "transferor," and the basis to the transferee of the property acquired, for the purposes of determining the amount of money or property paid in for stock, or as paid-in surplus, or as a contribution to the capital of the transferee pursuant to the provisions of section 718 (a) as a result of such exchange, is a substituted basis under section 113 (b) (2) (A), i. e., is a basis determined by reference to the basis of such property in the hands of the transferor.

(b) *Applicability of section 760 to various types of exchanges*—(1) *In general.* A substituted basis within the provisions of section 113 (b) (2) (A) may result from:

(i) The application of section 113 (a) (7) to property acquired in an exchange in a taxable year beginning after December 31, 1917, pursuant to a plan of reorganization under the provisions of section 112 (g);

(ii) The application of section 113 (a) (8) to property acquired in a taxable year beginning after December 31, 1920, by a corporation by the issuance of its stock or securities, if immediately after such acquisition the transferor is in control of the corporation under the provisions of section 112 (b) (5), or by a corporation as paid-in surplus or as a contribution to capital;

(iii) The application of section 113 (a) (17) and section 372 in certain instances to property acquired in connection with exchanges and distributions in obedience to certain orders of the Securities and Exchange Commission;

(iv) The application of section 113 (a) (20) to property acquired in certain railroad reorganizations;

(v) The application of section 113 (a) (21) to property acquired by certain street, suburban, or interurban electric railway corporations; and

(vi) The application of section 23.38 (b) of Consolidated Income Tax Return Regulations 104, or § 33.38 (b) of this chapter, property acquired by a member of an affiliated group of corporations from another member of such group during a consolidated return period.

The rules provided with respect to the provisions of the Code and of the consolidated returns regulations mentioned in this section shall also be applicable with respect to corresponding provisions of prior revenue laws and of prior consolidated returns regulations.

Example. In 1939 Corporation X, solely in exchange for 1,000 shares of its common voting stock (representing 5 percent of its total voting stock), acquired in a statutory reorganization under section 112 (g) (1) (C) all the assets of Corporation Y. Under section 113 (a) (7) (B), the basis of such assets in the hands of Corporation X would be determined by reference to the basis of such assets in the hands of Corporation Y. The amount to be included in the equity invested capital of Corporation X as the amount paid in for stock of Corporation X as a result of such exchange shall be determined under section 760.

The mere fact that property was acquired in an exchange pursuant to a plan of reorganization in which gain or loss was not recognized does not of itself invoke the provisions of section 760 if the basis of the property is not fixed by reference to the basis in the hands of the transferor. Thus, if the exchange described in the preceding example occurred in 1935, the basis of the assets to Corporation X would be fair market value at the date of the exchange because of failure of Corporation Y to retain the 50 percent control in such assets pursuant to section 113 (a) (7) (A), and the provisions of section 760 would be inapplicable in determining the amount includible in the equity invested capital of Corporation X as a result of the exchange.

(2) *Exchanges constituting intercorporate liquidations.* Since section 760 is applicable only in the determination of the amount paid in for stock, or as paid-in surplus, or as a contribution to capital, of a transferee upon an exchange, such section shall not be applicable in determining the equity invested capital of such transferee in the case of the receipt of property in any of the exchanges described in this section if the receipt of such property is a distribution in an intercorporate liquidation, in whole or in part, of the transferor within the provisions of section 761. In such cases, the exchange shall be considered to be an intercorporate liquidation subject to the provisions of section 761. For rules relating to the adjustment of equity invested capital in the case of intercorporate liquidations see section 761 and § 35.761–7.

The provisions of this paragraph may be illustrated by the following example:

Example. Prior to 1940, Corporation A owned the entire outstanding capital stock of Corporation B. In 1940, Corporation C acquired all of the assets of Corporation A and Corporation B in a statutory consolidation constituting a reorganization under section 112 (g) (1) (A). Although Corporation C might be deemed to have acquired the assets of Corporation B with a basis determined by reference to the basis of such assets in the hands of Corporation B, the provisions of section 760 are not applicable to such exchange since section 761 (f) provides that, in such a case, Corporation C shall be considered to have acquired in the statutory consolidation the stock of Corporation B previously owned by Corporation A and to have received the assets of Corporation B in an intercorporate liquidation.

(c) *Determination of basis of property received*—(1) *General rule.* In determining the amount paid in for stock, or as paid-in surplus, or as a contribution to capital of the transferee for the purposes of section 718 (a) with respect to an exchange, the basis of the property received upon the exchange is to be determined in accordance with the rules provided by section 718 (a) (2), namely, the basis (unadjusted) to the transferee for determining loss, adjusted with respect to the period prior to its receipt by the transferee, by an amount equal to the adjustments proper under section 115 (l) for determining earnings and profits. For the purposes of determining such basis (unadjusted) to the transferee, the amount of any gain or loss recognized to the transferor upon the exchange shall be limited to the gain or loss taken into account under section 115 (l) in computing the earnings and profits of the transferor. If the property was not disposed of prior to the taxable year, such unadjusted basis shall be determined under the law applicable to the taxable year. If the property was acquired in a taxable year beginning after February 28, 1913, and prior to January 1, 1934, and the basis of such property was prescribed by section 113 (a) (6), (7), or (9) of the Revenue Act of 1932, or if the property was acquired in a taxable year beginning after February 28, 1913, and prior to January 1, 1936, and the basis of such property was prescribed by section 113 (a) (6), (7), or (8) of the Revenue Act of 1934, for the purposes of section 760 the basis of such property shall be the same as the basis prescribed by the Revenue Act of 1932 or the Revenue Act of 1934, respectively. See section 113 (a) (12) and (16). If the property was disposed of prior to the taxable year, such unadjusted basis shall be that prescribed by the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913.

(2) *Applicability of section 760 in case of statutory change.* If the transferee received property in any taxable year in a transaction which, under the revenue law applicable to such year, did not constitute an exchange within the provisions of section 760 (a), and if:

(i) Such property is held in the taxable year, and under the revenue law applicable to such year such transaction qualifies as an exchange under section 760, or

(ii) Such property was disposed of in a taxable year subsequent to the year of acquisition and under the revenue law applicable to such subsequent taxable year, the transaction did qualify as an exchange under section 760,

the provisions of section 760 are applicable in determining the amount paid in to the transferee as a result of such transaction. However, if such property was disposed of prior to a year in which the revenue law was changed so as to bring a transaction of such a character within the provisions of section 760, the provisions of section 760 shall not be applicable in determining the invested capital of the transferee attributable to the property acquired in such transaction.

Thus, if after December 31, 1917, a corporation acquired the entire assets of another corporation in exchange solely for 79 percent of its voting stock, although such transaction would constitute a reorganization and a tax-free exchange under the Revenue Acts of 1924, 1926, and 1928, the basis of the assets to the transferee would not be determined by reference to the basis of such assets in the hands of the transferor since an interest or control of 80 percent in the assets transferred did not remain in the transferor. See sections 203 (b) (3) and (4), 203 (h) (1) A, and 204 (a) (7) of the Revenue Acts of 1924 and 1926, and

sections 112 (b) (3) and (4), 112 (i) (1) (A), and 113 (a) (7) of the Revenue Act of 1928. The percentage of control necessary to establish a substituted basis for such property was reduced to 50 percent by section 113 (a) (7) of the Revenue Acts of 1932 and 1934. The Revenue Act of 1936 removed the necessity for any control under section 113 (a) (7), but preserved the basis established under the Revenue Act of 1932 or 1934. The Revenue Act of 1938 and the Code provide in section 113 (a) (7) (A) that with respect to property acquired by a corporation in connection with a reorganization after December 31, 1917, but in a taxable year beginning prior to January 1, 1936, 50 percent control is necessary for the property transferred to have a basis to the transferee fixed by reference to the basis of the property in the hands of the transferor. In the case of property acquired in connection with a reorganization after December 31, 1935, no such control is necessary.

Example. Assume that in 1926, Corporation C acquired all the property of Corporation D in exchange for 79 percent of its entire capital stock, all of which was voting stock. Although the transaction would have been a reorganization and a tax-free exchange, the basis of the property to Corporation C in any taxable year beginning before January 1, 1932, would not have been fixed by reference to the basis of such property in the hands of Corporation D. Consequently, if Corporation C had disposed of the property prior to January 1, 1932, the amount paid in to Corporation C as a result of the 1926 exchange would not be determined under section 760. If Corporation C had disposed of the property in a taxable year beginning subsequent to December 31, 1931, the basis of such property to Corporation C would be the basis to Corporation D, and the amount paid in to Corporation C as a result of the 1926 exchange would be computed under section 760.

(3) *Inconsistent position.* As to the effect of an inconsistent position in the determination of invested capital under section 760, or without regard to its provisions, see section 734 and the regulations thereunder.

§ 35.760–2 *Determination of amount paid in for stock, or as paid-in surplus, or as a contribution to capital.* For the purposes of section 718 (a), the amount of money or property determined to have been paid in for stock of the transferee, or as paid-in surplus or as a contribution to capital of the transferee in connection with an exchange defined in § 35.760–1 (a) shall be the excess of the basis (determined under § 35.760–1 (b)) in the hands of the transferee of the property of the transferor received by the transferee upon the exchange over the sum of:

(a) The amount of any liability of the transferor assumed upon the exchange and of any liability subject to which such property was so received, plus.

(b) The amount of any liability of the transferee (not arising out of any liability described in (a) of this section) constituting consideration for the property so received, plus

(c) The aggregate of the amount of any money and the fair market value of any other property (other than such stock and other than property described in (a) and (b) of this section) transferred to the transferor, whether or not such money or property was permitted to be received by the transferor without the recognition of gain.

If the sum of the amounts specified in (a), (b), and (c) of this section exceeds the basis in the hands of the transferee of the property received from the transferor, such excess shall not be taken into account in computing the equity invested capital of the transferee but shall be used to reduce the daily invested capital of the transferee for each day after the exchange. As to the computation to be made in case of such excess, see § 35.760–3.

The application of the provisions of this section may be illustrated by the following examples:

Example (1). In 1942 Corporation X transferred property which had an adjusted basis for determining gain or loss of $600,000 to Corporation Y in consideration (1) of 80 percent of the capital stock of Corporation Y which had a fair market value of $400,000; (2) of the assumption by Corporation Y of open account indebtedness of Corporation X amounting to $20,000; (3) of the payment by Corporation Y of money and other property amounting to $120,000; and (4) of the issuance by Corporation Y to Corporation X of a bond in the amount of $110,000 secured by a lien upon the property acquired. Included in the property acquired by Corporation Y in connection with the foregoing exchange was a building which was subject to a mortgage liability of $100,000 which was not assumed by Corporation X and which was not assumed by Corporation Y. The money and other property received by Corporation X was not distributed in pursuance of the plan of reorganization and therefore the gain resulting from the exchange was recognized by such corporation in accordance with section 112 (d) (2). The amount includible in the equity invested capital of Corporation Y determined under the provisions of section 760 (b) with respect to the exchange is $370,000, computed as follows:

Gain to Corporation X Recognized Upon Exchange

Fair market value of capital stock of Corporation Y	$400,000
Amount of liabilities of Corporation X assumed	20,000
Bond secured by lien upon property	110,000
Money and other property	120,000
Mortgage liability subject to which building was transferred	100,000
Total consideration	750,000
Less: Adjusted basis of property transferred	600,000
Gain	150,000

The gain recognized to Corporation X, however, is limited to $120,000, representing the sum of the money and fair market value of other property received by Corporation X which, pursuant to the plan of reorganization, was not distributed (see sections 112(d)(2) and 112(k)).

Amount deemed to be paid in for stock of Corporation Y under section 718(a) and section 760

Adjusted basis of property to Corporation X		$600,000
Add: Gain to Corporation X recognized upon exchange		120,000
Unadjusted basis for determining loss to Corporation Y		720,000
Deduct: Amount of liabilities of Corporation X assumed	$20,000	
Bonds issued by Corporation Y secured by lien upon property received	110,000	
Money and other property paid	120,000	
Mortgage liability subject to which building was acquired by Corporation Y	100,000	
		350,000
Amount deemed to have been paid in for stock of Corporation Y upon the exchange		370,000

Daily invested capital of Corporation Y resulting from the exchange

Amount deemed to have been paid in to Corporation Y upon the exchange		$370,000
Borrowed invested capital:		
Mortgage liability on building not assumed	$100,000	
Bond issued secured by lien upon property	110,000	
Total borrowed capital	210,000	
Borrowed invested capital (50 percent of $210,000)		105,000
Daily invested capital		475,000

Assume that in 1943, Corporation Y sold the properties acquired from Corporation X for $750,000, the purchaser paying cash in the amount of $650,000 and taking the building subject to the mortgage liability of $100,000. The gain recognized to Corporation Y, and included in its earnings and profits, is $30,000 ($750,000 minus $720,000). There were no other accumulated earnings and profits. Immediately thereafter Corporation Y redeemed and canceled the bond and mortgage it had issued to Corporation X at the time of the exchange. That portion of the daily invested capital of Corporation Y for the excess profits tax taxable year following the year of the sale and attributable to the acquisition and sale of the properties received from Corporation X would be $400,000, computed as follows:

Equity invested capital resulting from the exchange	$370,000
Earnings and profits from sale of properties	30,000
Daily invested capital	400,000

Example (2). Assume that in the preceding example, the money and other property received by Corporation X upon the exchange were distributed pursuant to the plan of reorganization so that no gain was recognized to Corporation X as a result of the exchange (see sections 112 (d) (1) and 112 (k)). Consequently, the basis of the property received by Corporation Y would not be increased by any gain recognized to Corporation X pursuant to section 113 (a) (7), and would be $600,000, rather than $720,000. The

amount deemed to have been paid in for stock of Corporation Y upon the exchange would be $250,000 instead of $370,000, and the daily invested capital of Corporation Y resulting from the exchange would be $355,000 instead of $475,000. Upon the sale of the property, however, a gain of $150,000, rather than $30,000, would be realized, and the accumulated earnings and profits of Corporation Y would be increased accordingly by $150,000 instead of $30,000. That portion of the daily invested capital of Corporation Y for the excess profits tax taxable year following the year of the sale and attributable to the acquisition and sale of the properties received from Corporation X would be $400,000 ($250,000 plus $150,000).

§ 35.760–3 *Reduction in daily invested capital.* For the purposes of determining the daily invested capital of the transferee upon an exchange pursuant to the provisions of section 717 for any day after such exchange, the daily invested capital for each such day shall be reduced by an amount equal to the excess of the sum of the amounts specified in section 760 (b) (1), (2), and (3) over the basis (determined in accordance with § 35.760–1 (b)) to the transferee of the property of the transferor received upon the exchange.

In any case in which the excess of the sum of the amounts specified in section 760 (b) (1), (2), and (3) over the basis of the transferee of the property received upon the exchange is greater than the amount of the daily invested capital for any day after such exchange, the daily invested capital for such day shall be a minus quantity. In such case the average invested capital of the taxpayer computed under section 716 shall be the aggregate of the daily invested capital for each day of the taxable year computed by taking into account any plus amounts in daily invested capital and any negative amounts in daily invested capital after the exchange resulting from the application of section 760 (c), divided by the number of days in such taxable year. In no case, however, shall such average invested capital be an amount which is less than zero.

The provisions of this section may be illustrated by the following examples:

Example (1). In 1942 Corporation O owned property with an adjusted basis for determining gain or loss of $400,000 but with a fair market value of $1,000,000. Corporation O had no accumulated earnings and profits or deficit in earnings and profits. On June 30, 1942, pursuant to a plan of reorganization, Corporation P acquired such property from Corporation O in exchange for 80 percent of its outstanding stock which had a fair market value of $400,000, $125,000 in cash, and $475,000 of its short term notes. Immediately prior to the exchange Corporation P had an equity invested capital of $100,000, consisting of money and property paid in and of accumulated earnings and profits. Under section 112 (d) (1) no gain was recognized to Corporation O upon the exchange since immediately after the exchange and in pursuance of the plan of reorganization it distributed the cash and stock and notes of Corporation P to its shareholders. The daily invested capital of Corporation P for each day after the exchange was $137,000 and the average invested capital for the taxable year 1942 was $118,904.11, computed as follows:

Daily invested capital of Corporation P immediately after exchange

Equity invested capital immediately prior to exchange		$100,000.00
Amount deemed to have been paid in under sections 718 (a) and 760 upon the exchange		0
Borrowed invested capital of Corporation P (50 percent of $475,000)		237,500.00
Total daily invested capital prior to application of section 760 (c)		337,500.00
Less: Amount provided by section 760 (c) as reduction in daily invested capital:		
Cash paid upon the exchange	$125,000.00	
Notes issued by Corporation P	475,000.00	
Total	600,000.00	
Less: Basis of property received upon exchange	400,000.00	
Reduction under section 760 (c)		200,000.00
Daily invested capital for each day after exchange		137,500.00

Average invested capital of Corporation P for 1942

Aggregate of daily invested capital for each day prior to and including the days of the exchange ($100,000×181 days)	$18,100,000.00
Aggregate of daily invested capital for each day after the exchange ($137,500×184 days)	25,300,000.00
Total aggregate daily invested capital for each day of the taxable year	43,400,000.00
Average invested capital ($43,400,000 divided by 365 days)	118,904.11

Example (2). In 1942 Corporation A owned property with an adjusted basis for determining gain or loss of $1,300,000 but with a fair market value of $4,500,000. Corporation A had no accumulated earnings and profits or deficit in earnings and profits. On June 30, 1942, pursuant to a plan of reorganization Corporation B acquired such property from Corporation A in exchange for 80 percent of its outstanding stock which had a fair market value of $1,500,000, cash of $500,000, and bonds of $2,500,000. Immediately prior to the exchange Corporation B had an equity invested capital of $375,000 consisting of money paid in and of accumulated earnings and profits. Under section 112 (d) (1) no gain was recognized to Corporation A upon the exchange since immediately after the exchange and pursuant to the plan of reorganization it distributed the cash and bonds of Corporation B to its shareholders. The daily invested capital of Corporation B for each day after the exchange is minus $75,000 and the average invested capital for the taxable year 1942 is $148,150.68, computed as follows:

Daily invested capital immediately after the exchange

Equity invested capital of Corporation B immediately prior to the exchange		$375,000.00
Amount deemed to have been paid in upon the exchange		0
Borrowed invested capital (50 percent of $2,500,000)		1,250,000.00
Total daily invested capital prior to application of section 760 (c)		1,625,000.00
Less: Amount provided by section 760 (c) as reduction in daily invested capital:		
Cash paid upon the exchange	$500,000.00	
Bonds issued upon the exchange	2,500,000.00	
Total	3,000,000.00	
Less basis of property received upon exchange	1,300,000.00	
Reduction under section 760 (c)		1,700,000.00
Daily invested capital for each day immediately after exchange (a minus quantity)		(75,000.00)

Average invested capital of Corporation B for 1942

Aggregate of daily invested capital for each day prior to and including the day of the exchange ($375,000×181 days)	$67,875,000.00
Aggregate of daily invested capital for each day after the exchange (($75,000)×184 days) (a minus quantity)	(13,800,000.00)
Total aggregate daily invested capital for each day of the taxable year	54,075,000.00
Average invested capital ($54,075,000 divided by 365 days)	148,150.68

SEC. 761. INVESTED CAPITAL ADJUSTMENT AT THE TIME OF TAX-FREE INTERCORPORATE LIQUIDATIONS. [Added by sec. 230 (a), Rev. Act 1942.]

(a) *Definition of intercorporate liquidation.* As used in this section, the term "intercorporate liquidation" means the receipt (whether or not after December 31, 1941) by a corporation (hereinafter called the "transferee") of property in complete liquidation of another corporation (hereinafter called the "transferor") to which

(1) The provisions of section 112 (b) (6), or the corresponding provision of a prior revenue law, is applicable or

(2) A provision of law is applicable prescribing the nonrecognition of gain or loss in whole or in part upon such receipt (including a provision of the regulations applicable to a consolidated income or excess profits tax return but not including section 112 (b) (7), (9), or (10) or a corresponding provision of a prior revenue law), but only if none of such property so received is a stock or a security in a corporation the stock or securities of which are specified in the law applicable to the receipt of such property as stock or securities permitted to be received (or which would be permitted to be received if they were the sole consideration) without the recognition of gain.

(b) *Definition of plus adjustment and minus adjustment.* For the purposes of this section—

(1) *Plus adjustment.* The term "plus adjustment" means the amount, with respect to an intercorporate liquidation, determined to be equal to the amount by which the aggregate of the amount of money received by the transferee in such intercorporate liquidation, and of the adjusted basis at the time of such receipt of all property (other than money) so received, exceeds the sum of—

(A) the aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

(B) the aggregate of the liabilities of the transferor assumed by the transferee in connection with the receipt of such property, of the liabilities (not assumed by the transferee) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the transferee for such property so received.

(2) *Minus adjustment.* The term "minus adjustment" means the amount, with respect to an intercorporate liquidation, determined to be equal to the amount by which the sum of—

(A) the aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

(B) the aggregate of the liabilities of the transferor assumed by the transferee in connection with the receipt of such property, of the liabilities (not assumed by the transferee) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the transferee for such property so received

exceeds the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received.

(3) *Rules for application of paragraphs (1) and (2).* In determining the plus adjustment or minus adjustment with respect to any share, the computation shall be made in the same manner as is prescribed in paragraphs (1) and (2) of this subsection, except that there shall be brought into account only that part of each item which is determined to be attributable to such share.

(c) *Rules for the application of this section*—(1) *Stock having cost basis.* The property received by a transferee in an intercorporate liquidation attributable to a share of stock having in the hands of the transferee a basis determined to be a cost basis, shall be considered to have, for the purposes of subsection (b), an adjusted basis at the time so received determined as follows:

(A) The aggregate of the property (other than money) held by the transferor at the time of the acquisition by the transferee of control of the transferor (or, if such share was acquired after the acquisition of such control, at the time of the acquisition of such share, or, if such control was not acquired, at the time immediately prior to the receipt of any property in the intercorporate liquidation in respect of such share) shall be deemed to have an aggregate basis equal to the amount obtained by (i) multiplying the amount of the adjusted basis at such time of such share in the hands of the transferee by the aggregate number of share units in the transferor at such time (the interest represented by such share being taken as the share unit), and (ii) adjusting for the amount of money on hand and the liabilities of the transferor at such time.

(B) The basis which property of the transferor is deemed to have under subparagraph (A) at the time therein specified shall be used in determining the basis of property subsequently acquired by the transferor the basis of which is determined with reference to the basis of property specified in subparagraph (A).

(C) The basis which property of the transferor is deemed to have under subparagraphs (A) and (B) at the time therein specified shall be used in determining all subsequent adjustments to the basis of such property.

(D) The property so received by the transferee shall be deemed to have, at the time of its receipt, the same basis it is deemed to have under the foregoing provisions of this paragraph in the hands of the transferor, or in the case of property not specified in subparagraph (A) or (B), the same basis it would have had in the hands of the transferor.

(E) Only such part of the aggregate property received by the transferee in the intercorporate liquidation as is attributable to such share shall be considered as having the adjusted basis which property is deemed to have under subparagraphs (A), (B), (C), and (D) of this paragraph.

(2) *Basis of stock not a cost basis.* The property received by a transferee in an intercorporate liquidation attributable to a share of stock having in the hands of the transferee a basis determined to be a basis other than a cost basis shall, for the purposes of subsection (b), be considered to have, at the time of its receipt, the basis it would have had had the first sentence of section 113 (a) (15) been applicable.

(3) *Definition of control.* As used in this subsection, the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the ownership of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), but only if in both cases such ownership continues until the completion of the intercorporate liquidation.

(d) *Adjustment of equity invested capital.* If property is received by the transferee in an intercorporate liquidation, in computing the equity invested capital of the transferee for any day following the completion of such intercorporate liquidation—

(1) with respect to any share of stock in the transferor having in the hands of the transferee, immediately prior to the receipt of any property in such intercorporate liquidation, a basis determined to be a cost basis, the earnings and profits or deficit in earnings and profits of the transferee shall be computed as if on the day following the completion of such intercorporate liquidation the transferee had realized a recognized gain equal to the amount of the plus adjustment in respect of such share, or had sustained a recognized loss equal to the amount of the minus adjustment in respect of such share;

(2) with respect to any share of stock in the transferor having in the hands of the transferee, immediately prior to the receipt of any property in such intercorporate liquidation, a basis determined to be a basis other than a cost basis, there shall be treated as an amount includible in the sum specified in section 718 (a) the amount of the plus adjustment with respect to such share, or as an amount includible in the sum specified in section 718 (b) the amount of the minus adjustment with respect to such share.

(e) *Invested capital basis.* The adjusted basis which property received by the transferee in an intercorporate liquidation is considered to have under the provisions of subsection (c) at the time of its receipt shall be thereafter treated as the adjusted basis, in lieu of the adjusted basis otherwise prescribed, in computing any amount, determined by reference to the basis of such property in the hands of the transferee, entering into the computation of the invested capital of the transferee, or of any other corporation the computation of the invested capital of which is determined by reference to the basis of such property in the hands of the transferee.

(f) *Statutory mergers and consolidations.* If a corporation owns stock in another corporation and such corporations are merged or consolidated in a statutory merger or consolidation, then for the purposes of this section and section 718 such stock shall be considered to have been acquired (in such statutory merger or consolidation) by the corporation resulting from the statutory merger or consolidation, and the properties of such other corporation attributable to such stock to have been received by such resulting corporation as a transferee from such other corporation as a transferor in an intercorporate liquidation.

(g) *Determination*—(1) *Regulations.* Any determination which is required to be made under this section (including determinations in applying this section in cases where there is a series of transferees of the property and cases where the stock of the transferor is acquired by the transferee from another corporation, and the determinations of the basis and adjusted basis which property or items thereof have or are considered to have) shall be made in accordance with regulations which shall be prescribed by the Commissioner with the approval of the Secretary. If the transferor or the transferee is a foreign corporation, the provisions of this section shall apply to such extent and under such conditions and limitations as may be provided in such regulations.

(2) *Application to liquidation extending over long period.* The Commissioner is authorized to prescribe rules similar to those provided in this section with respect to the days within the period beginning with the date on which the first property is received in the intercorporate liquidation and ending with the day of its completion; and the extent to which, and the conditions and limitations under which, such rules are to be applicable.

§ 35.761–1 *Intercorporate liquidation*—(a) *General rule.* For the purposes of section 761, the term "intercorporate liquidation" means the receipt (whether or not after December 31, 1941) by a corporation (hereinafter called the "transferee") of property in complete liquidation of another corporation (hereinafter called the "transferor") to which:

(1) The provisions of section 112 (b) (6), or the corresponding provisions of a prior revenue law, are applicable, including the case in which an election has been made pursuant to the last sentence of section 113 (a) (15) of the Revenue Act of 1936, as amended by section 808 of the Revenue Act of 1938, or

(2) A provision of law is applicable prescribing the nonrecognition of gain or loss in whole or in part upon such receipt, including a provision of the regulations applicable to a consolidated income tax return or a consolidated excess profits tax return, but not including the provisions of section 112 (b) (7) of the Revenue Act of 1938 relating to certain complete liquidations occurring during December 1938, or the provisions of section 112 (b) (9) relating to certain complete liquidations of railroad corporations. The provisions of regulations applicable to consolidated income or excess profits

tax returns which provide for the nonrecognition, in whole or in part, of gain or loss upon a liquidation of a member of an affiliated group during a consolidated return period are article 37 of Regulations 75, 78, 89, 97, 102, section 23.37 of Regulations 104 and § 33.37 of this chapter. A liquidation of a member of an affiliated group during a taxable year, which is a consolidated return period, beginning prior to January 1, 1929, is not an intercorporate liquidation for the purposes of section 761, unless some provision of law other than regulations relating to consolidated returns is applicable prescribing the nonrecognition of gain or loss, in whole or in part, upon the liquidation. A liquidation of a member of an affiliated group during a taxable year, which is a consolidated return period, beginning after December 31, 1933, is not an intercorporate liquidation if it comes within the exceptions provided in articles 37 (a) and 38 (c) (3) of Regulations 89, article 37 (a) (1) and (2) of Regulations 97 and 102, section 23.37 (a) (1) and (2) of Regulations 104 and § 33.37 (a) (1) and (2) of this chapter.

The rules provided with respect to the sections of the Code mentioned in this section shall also be applicable with respect to corresponding sections of prior revenue laws.

(b) *Exception.* A transaction is an intercorporate liquidation within the meaning of the foregoing provisions only if none of the property received by the transferee is a stock or a security in a corporation, the stock or securities of which are specified in the law applicable to the receipt of such property as stock or securities permitted to be received (or which would be permitted to be received if they were the sole consideration) without the recognition of gain.

Thus, assume that Corporation P owned all the outstanding stock of Corporation S. Pursuant to a plan of reorganization, Corporation S transferred all its assets to Corporation S (1) in exchange for all the capital stock of Corporation S (1), and distributed such stock to Corporation P in liquidation. The entire property received by Corporation P upon the liquidation of Corporation S was stock in a corporation which pursuant to section 112 (b) (3) Corporation P was permitted to receive without the recognition of gain. Consequently, the transaction in which Corporation P acquired the stock of Corporation S (1) in complete liquidation of Corporation S is not an intercorporate liquidation within the provisions of section 761. If the reorganization had occurred in a taxable year beginning prior to January 1, 1934, and the stock of Corporation S (1) had been acquired pursuant to a plan of reorganization by Corporation P without the surrender of the stock of Corporation S, such acquisition by Corporation P of all the assets of Corporation S would not constitute an intercorporate liquidation within the meaning of section 761, since the stock of Corporation S (1) is a stock specified in section 112 (g) of the Revenue Act of 1932 and corresponding provisions of prior revenue laws as stock in a corporation permitted to be received without the recognition of gain. If the stock of Corporation S (1) was acquired by Corporation P in a taxable year beginning subsequent to December 31, 1933, without the surrender or cancellation or retirement of the stock of Corporation S, since the transaction would not be one in which gain or loss is not recognized to Corporation P, the transaction would not be an intercorporate liquidation under section 761. (See section 19.112 (g)–5 of Regulations 103 and § 29.112 (g)–5 of this chapter.

Assume that Corporation P owned the entire outstanding capital stock of Corporation S and that Corporation S owned the entire outstanding capital stock of Corporation S (1). If Corporation P acquired the stock of Corporation S (1) in a complete liquidation of Corporation S pursuant to the provisions of section 112 (b) (6), such liquidation would be an intercorporate liquidation within the provisions of section 761 since section 112 (b) (6) does not specify stock in any corporation as stock permitted to be received without the recognition of gain.

If, in connection with an intercorporate liquidation described in this section, there is also involved (1) the transfer by the transferor to the transferee of property not attributable to the shares of the transferor owned by the transferee in consideration of stock issued by the transferee in an exchange described in section 112 (b) (4) or in an exchange not within the provisions of section 112 (b); or (2) the transfer to the transferee by minority shareholders of the transferor of stock of the transferor in consideration of the issuance by the transferee of stock in an exchange described in section 112 (b) (3) or in an exchange not within the provisions of section 112 (b), the amount includible in the equity invested capital as a result of the receipt of such property or such stock in the exchanges described in (1) or (2) of this sentence shall be determined pursuant to the provisions of section 760 or of section 718 (a) (1) or (2), as the case may be. (See § 35.760–2 and § 35.718–1.)

(c) *Statutory merger or consolidation.* In any case in which one corporation owns stock in another corporation (hereinafter called the "transferring corporation"), whether or not such stock ownership amounts to control, and such corporations are merged or consolidated in a statutory merger or consolidation, for the purposes of section 761 and of section 718, the corporation resulting from the statutory merger or consolidation (hereinafter called the "resulting corporation") shall be considered first to have acquired the stock of such transferring corporation in the statutory merger or consolidation and then to have acquired the properties of such transferring corporation which are attributable to the stock considered to have been acquired by the resulting corporation in the statutory merger or consolidation as a transferee from the transferring corporation as a transferor in an intercorporate liquidation. The foregoing rule is equally applicable to all cases of statutory merger and consolidation, whether the resulting corporation operates under the charter of the parent, the subsidiary, or under a new charter.

(d) *Intercorporate liquidation involving foreign corporation.* An exchange which would otherwise be an intercorporate liquidation subject to the provisions of section 761, but which involves a foreign corporation as the transferor or transferee, shall not constitute an intercorporate liquidation for the purposes of section 761 if such exchange was consummated after June 6, 1932, and involved gain unless, prior to such exchange, it was established to the satisfaction of the Commissioner pursuant to the provisions of section 112 (i) and section 19.112 (i)–1 of Regulations 103 and § 29.112 (i)–1 of this chapter, or the corresponding provisions of prior revenue laws and regulations, that such exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

§ 35.761–2 *Definition of plus adjustment and minus adjustment.* For the purposes of determining the adjustment of equity invested capital under section 761 (d) and § 35.761–7:

(a) *Plus adjustment.* The term "plus adjustment" means the amount computed with respect to an intercorporate liquidation and determined to be equal to the amount by which the aggregate of the amount of money received by the transferee in the intercorporate liquidation and of the adjusted basis at the time of receipt of all property other than money, so received exceeds the sum of:

(1) The aggregate of the adjusted basis of each share of stock with respect to which the property was received in the intercorporate liquidation, and

(2) The aggregate of the liabilities of the transferor assumed by the transferee in connection with the receipt of the property in the intercorporate liquidation, of the liabilities (not assumed by the transferee) to which the property so received was subject, and of any other consideration other than the stock with respect to which such property was so received given by the transferee for such property so received.

(b) *Minus adjustment.* The term "minus adjustment" means the amount computed with respect to an intercorporate liquidation and determined to be equal to the amount by which the sum of:

(1) The aggregate of the adjusted basis of each share of stock with respect to which the property was received in the intercorporate liquidation, and

(2) The aggregate of the liabilities of the transferor assumed by the transferee in connection with the receipt of the property in the intercorporate liquidation, of the liabilities (not assumed by the transferee) to which the property so received was subject, and of any other consideration other than the stock with respect to which such property was so received given by the transferee for such property so received,

exceeds the aggregate of the amount of money received by the transferee in the

intercorporate liquidation and of the adjusted basis at the time of receipt of all property other than money so received.

(c) *Rules applicable in determining plus adjustment and minus adjustment.* For the purpose of determining the plus adjustment and the minus adjustment provided by section 761 (b):

(1) The adjusted basis of each share of stock with respect to which property is received upon the intercorporate liquidation shall be determined immediately prior to the receipt in the intercorporate liquidation of the property with respect to such share. As to the computation of the adjusted basis of such share, see § 35.761–4.

(2) The adjusted basis of property other than money at the time of receipt of such property shall be determined in accordance with the provisions of section 761 (c) and §§ 35.761–5 or 35.761–6. This adjusted basis may be different from the adjusted basis otherwise determined under the provisions of section 113.

(3) A share of stock with respect to which property is received upon an intercorporate liquidation means outstanding stock of the transferor owned by the transferee at the time of such liquidation. Outstanding stock of the transferor shall not include shares of the transferor held by it in its treasury as treasury stock. In the case of a complete liquidation of a transferor under the provisions of section 112 (b) (6), such stock refers only to stock of the transferor owned by the transferee at the time of the receipt of the property.

(4) The plus adjustment or the minus adjustment with respect to each share of stock shall be computed in the manner prescribed in section 761 (b) (1) and (2), except that there shall be brought into account only that part of each item specified in such section which is determined to be attributable to such share. The amount of any consideration (other than the stock of the transferor with respect to which property was received upon the intercorporate liquidation) given by the transferee for the property received upon the intercorporate liquidation shall be prorated with respect to each share of stock (other than stock which is limited and preferred as to assets upon liquidation) upon the basis of the percentage which one share of stock is of the total shares of stock of the transferor owned by the transferee at the time of liquidation (not including stock which is limited and preferred as to assets upon liquidation).

(5) In no event shall there be taken into account any plus adjustment with respect to a share of stock which is limited and preferred as to assets upon liquidation of the transferor in excess of the sum of:

(i) The excess of that portion of the net assets to which such share is entitled upon liquidation of the transferor over the adjusted basis to the transferee of such share at the time of liquidation, and

(ii) The amount of any cumulative dividends in arrears upon such share.

(6) Property received by a transferee in an intercorporate liquidation in exchange for stock of the transferee issued by the transferee to the transferor or to minority shareholders of the transfereror, whether or not in an exchange within the provisions of section 112 (b) (4) of the applicable revenue law, is not property received upon an intercorporate liquidation, but is property received upon an exchange under section 760 or property paid in under section 718 (a) (1) or (2). Consequently, other consideration given by the transferee for property received upon the intercorporate liquidation within the provisions of section 761 (b) (1) (B) or section 761 (b) (2) (B) does not include stock of the transferee issued in consideration for property which is received at the time of the intercorporate liquidation but which is received in an exchange under section 760 or which is paid in under section 718 (a) (1) or (2).

(d) *Rules applicable in case intercorporate liquidation extends over period of time.* If any distribution in an intercorporate liquidation occurs in an excess profits tax taxable year beginning after December 31, 1939, to which the provisions of section 761 are applicable, and if the liquidation is consummated by a series of distributions covering a period of more than one taxable year, the application of the principles of section 761 in the computation of the equity invested capital of the taxpayer shall, in addition to the requirements set forth in section 761, be subject to the following requirements:

(1) The taxpayer shall file with its excess profits tax return for the first excess profits tax taxable year to which the provisions of section 761 are applicable with respect to the intercorporate liquidation a statement describing the plan pursuant to which the distributions in liquidation have been or will be made and setting forth the period within which the transfer of the property of the transferor to the taxpayer has been or is to be completed.

(2) If the intercorporate liquidation involves a distribution in liquidation pursuant to the provisions of section 112 (b) (6), the taxpayer shall comply with the requirements prescribed by section 19.112 (b) (6)–3 of Regulations 103 or § 29.112 (b) (6)–3 of this chapter. As used in such section, the term "profits taxes" includes the excess profits tax imposed by Subchapter E of Chapter 2. The bond required by such section shall also contain provisions unequivocally assuring prompt payment of the excess of income and excess profits taxes (plus penalty, if any, and interest) as computed by the Commissioner without regard to the provisions of section 761 over such taxes computed with regard to such section, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 272 and regardless of whether it may or may not be assessed.

(3) If the intercorporate liquidation involves a distribution in liquidation other than one pursuant to section 112 (b) (6), in addition to the statement required by paragraph (1) for each of the taxable years which falls wholly or partly within the period of liquidation, the taxpayer shall, at the time of filing its excess profits tax return, file with the collector for transmittal to the Commissioner a waiver of the statute of limitations on assessment and collection. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period for assessment of all income and excess profits taxes for such year to a date not earlier than one year after the last date of the period for assessment of such taxes for the last taxable year in which the transfer of the property of the transferor to the transferee may be completed pursuant to the plan filed by the taxpayer. Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation. For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall file a bond, the amount of which shall be fixed by the Commissioner. The bond shall contain all terms specified by the Commissioner, including provisions unequivocally assuring prompt payment of the excess of the income and excess profits taxes (plus penalty, if any, and interest) as computed by the Commissioner without regard to the provisions of section 761 over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 272 and regardless of whether it may or may not be assessed. Any bond required under this paragraph shall have such surety or sureties as the Commissioner may require. However, see section 1126 of the Revenue Act of 1926, as amended, providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or the depository may each have a copy.

(4) Pending the completion of the liquidation, if there is a compliance with this section and § 35.761–1 with respect to intercorporate liquidations, the equity invested capital of the taxpayer for each day following a distribution in liquidation of the transferor shall be determined under section 761, and the plus adjustment or minus adjustment for each such day shall be computed under section 761 (b) subject to the following rules:

(i) If a distribution in liquidation is in complete cancellation and retirement of any specific share or shares of stock of the transferor, a plus adjustment or a minus adjustment with respect to such share or shares shall be computed at the time such distribution occurred pursuant to the provisions of § 35.761–2 (c), and the money and property received upon the distribution, the liabilities of the transferor assumed at the time of the distribution, the liabilities to which the property received in the distribution was

subject, and any other consideration (other than the stock of the transferor with respect to which the distribution was received) shall be taken into account in computing the plus adjustment or minus adjustment with respect to such distribution and shall not be allocated to any prior or subsequent distribution.

(ii) If the distribution in liquidation is not in complete cancellation and retirement of any specific share or shares, but extends ratably over all the outstanding shares of the transferor or over all the outstanding shares of a particular class of stock of the transferor, a plus adjustment or a minus adjustment shall be computed at the time of each distribution in accordance with the provisions of § 35.761–2 (c), and:

(*a*) The distribution shall be considered a distribution with respect to each share (or each share of a particular class) held by the transferee;

(*b*) The adjusted basis of each share for the purposes of computing the plus adjustment or the minus adjustment at the time of any distribution shall bear that ratio to the total adjusted basis of such share computed under § 35.761–4 as the excess of the aggregate of the money and adjusted basis (computed under § 35.761–5) of all property other than money received from the transferor as a distribution over the aggregate of the liabilities of the transferor assumed by the transferee or to which property received from the transferor was subject, bears to the excess of the aggregate of the money and adjusted basis of all property other than money (computed under § 35.761–5) held by the transferor at the time of the first distribution in liquidation over the aggregate of the liabilities of the transferor and liabilities to which the property held by the transferor was subject, at the time of the first distribution in liquidation. In no event, however, shall the portion of the total adjusted basis of a share of stock used in computing the plus adjustment or the minus adjustment under this paragraph exceed an amount which, when added to portions of such basis previously used in computing the plus adjustment or minus adjustment in connection with such intercorporate liquidation, equals the total adjusted basis of such share computed under § 35.761–4;

(c) The amount of any consideration (other than the stock of the transferor with respect to which the distribution was received) given by the transferee at the time of the distribution and the amount of any liability of the transferor assumed at the time of the distribution or any liability to which the property received in the distribution was subject shall be taken into account in computing the plus adjustment or the minus adjustment with respect to such distribution, and shall not be allocated to any other prior or subsequent distribution.

(iii) In no event shall the aggregate of the plus adjustments and minus adjustments computed with respect to an intercorporate liquidation extending over a period of time be different for each day after the last day of the last distribution in liquidation than the plus adjustment or minus adjustment which would have resulted had the intercorporate liquidation been commenced and completed entirely during such last day.

§ 35.761–3 *Determination of basis of stock; cost basis or basis other than cost*—(a) *Cost basis.* In all cases other than those in which the basis of stock is determined to be a basis other than cost under (b) or (c) of this section, the basis of stock shall be determined to be a cost basis.

(b) *Basis other than cost.* Stock in any corporation shall be determined to have a basis other than cost if, as a result of the transaction in which such stock was acquired:

(1) The basis of such stock is fixed by reference to the basis of other property previously held by the acquiring corporation, not including any case in which the basis of such other property to such corporation was a cost basis if, at the time of the acquisition of such stock or immediately thereafter, the acquiring corporation or its shareholders were in control of the corporation from which such stock was acquired or the corporation from which such stock was acquired or its shareholders were in control of the acquiring corporation; or

(2) The basis of such stock is fixed by reference to its basis in the hands of a preceding owner not including any case in which:

(i) Such stock was acquired from another member of an affiliated group of corporations in a taxable year in which the acquiring corporation and the transferring corporation filed a consolidated income or excess profits tax return and

(*a*) The basis of such stock to the transferring corporation was a cost basis, or

(*b*) The basis of the stock of the transferring corporation or of any other member of the affiliated group holding stock of the transferring corporation, directly or indirectly, was a cost basis, whether or not the basis to the transferring corporation of the stock transferred was a cost basis (see § 35.761–4 (c)) relating to amount of basis) except in those cases in which such stock would have a basis other than cost if it had been acquired in an intercorporate liquidation described in (ii) or in an exchange described in (iii); or

(ii) Such stock was acquired in an intercorporate liquidation if immediately prior to such liquidation the stock of the liquidated corporation was held by the acquiring corporation with a cost basis (see section 761 (e)), or the stock which was acquired in such liquidation was held by the liquidated corporation with a cost basis; or

(iii) Such stock was acquired from another member of a controlled group of corporations and

(*a*) The basis of such stock to the preceding owner was a cost basis, or

(*b*) The basis of the stock of the transferring corporation or of any other member of the controlled group holding stock of the transferring corporation, directly or indirectly, was a cost basis, whether or not the basis to the transferring corporation of the stock transferred was a cost basis (see § 35.761–4 (c)) relating to amount of basis) except in those cases in which such stock would have a basis other than cost if it had been acquired in an intercorporate liquidation described in (ii);

Provided, That if, in the opinion of the Commissioner, the liquidation of the transferor whose stock was acquired in a transaction subject to the provisions of (b) (2) (i) and (iii) has the effect of a substitution of one member of a controlled group for another member of such group, the provisions of (b) (2) (i) and (iii) shall not be applicable. For the purposes of this section a controlled group includes one or more chains of corporations connected through stock ownership with a common parent corporation if stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations and the common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other corporations. As used in the preceding sentence, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(c) *Statutory merger or consolidation.* In any case in which a corporation held stock in another corporation and such corporations were merged or consolidated in a statutory merger or consolidation, such stock, for the purposes of section 761 (f), shall be determined to have a cost basis in the hands of the corporation resulting from the merger or consolidation if such stock was held with a cost basis immediately prior to the statutory merger or consolidation and if, immediately thereafter, the shareholders of the holding corporation were in control of the corporation resulting from the statutory merger or consolidation. In all other cases, such stock shall be determined to have a basis other than cost in the hands of the corporation resulting from the statutory merger or consolidation.

(d) *Control.* For the purposes of this section, in determining whether the basis of stock is a cost basis or a basis other than a cost basis, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation (except nonvoting stock which is limited and preferred as to dividends).

(e) *Series of stock transfers.* The rules provided in this section shall be applicable in determining the basis of stock held by a transferee where there has been a series of transfers of such stock.

§ 35.761–4 *Computation of basis of stock; amount of basis.* The following rules are applicable in determining the adjusted basis of the stock with respect

to which the property was received in the intercorporate liquidation, for the purposes of the computation of the plus adjustment or the minus adjustment under section 761 (b):

(a) *Time of computation.* The adjusted basis of each share of stock with respect to which property is received in an intercorporate liquidation shall be determined immediately prior to the receipt of any property in such liquidation with respect to such share. In case of the receipt by a corporation in a statutory merger or consolidation of shares of stock of another corporatiton, the properties of which are deemed to have been transferred to the acquiring corporation with respect to such stock, the adjusted basis of such stock shall be determined immediately prior to the statutory merger or consolidation.

(b) *Determination of basis.* The adjusted basis of each share of stock shall be the unadjusted basis for determining loss upon a sale or exchange, adjusted by amounts proper under section 115 (l) for determining earnings and profits, under the law applicable to the year in which the intercorporate liquidation began. If such stock has a basis fixed by reference to the basis of such stock in the hands of any preceding owner, the basis of such stock to the transferee upon its receipt shall be the basis to the prior owner determined without regard to its value as of March 1, 1913, and adjusted in the hands of the prior owner (and in the hands of any owners prior to such prior owner if the basis of such stock is determined by reference to the basis in the hands of such other prior owners) by an amount equal to the adjustments proper under section 115 (l) for determining earnings and profits. In any case in which such stock has a basis to the transferee fixed by reference to the basis of such stock in the hands of any preceding owner, and the basis of such stock in the hands of such preceding owner is different for invested capital purposes, because of the provisions of section 761, than for the purposes of determining gain or loss upon a sale or exchange, the basis of such stock for invested capital purposes, rather than the basis for determining gain or loss upon a sale or exchange, shall be used in determining the unadjusted basis of such stock to the transferee. If the basis of such stock to the preceding owner was a cost basis which is preserved to the transferee, and if the preceding owner was in control of the transferor as defined in section 761 (c) (3), the adjustments prescribed by this section with respect to stock owned by a transferee shall also be made with respect to the stock owned by the preceding owner for the purposes of determining the unadjusted basis of such stock to the transferee.

(c) *Acquisition of stock from member of affiliated or controlled group.* If stock of a corporation was acquired by a member of an affiliated group of corporations from another member of such affiliated group in a transaction subject to the provisions of § 35.761–3 (b) (2) (i) (*b*), or by a member of a controlled group of corporations as defined in § 35.761–3 (b) (2) from another member of such controlled group in a transaction subject to the provisions of § 35.761–3 (b) (2) (iii) (*b*), the basis of such stock to the acquiring corporation shall be an amount equal to the basis which such stock would have determined pursuant to the provisions of section 761 (c) (1) and (e) if such stock were acquired as the result of an intercorporate liquidation of the corporation transferring such stock and of each member of the group owning stock of the transferring corporation, directly or indirectly, through which such stock would have passed prior to its acquisition by the member of the group.

(d) *Nonapplication of adjustment based on loss during consolidated return period.* If the transferee owns stock of a transferor with which it has made a consolidated income or excess profits tax return, the basis of such stock shall not be reduced pursuant to the provisions of section 113 (a) (11), or § 33.34 (c) of this chapter, or section 23.34 (c) of Regulations 104, or corresponding provisions of prior consolidated returns regulations, or similar rules of law applicable to consolidated returns, relating to decrease in basis of stock of a corporation on account of losses sustained by such corporation during a consolidated return period.

(e) *Precontrol distributions in case of cost basis stock.* As of the date of acquisition of control by the transferee (or as of the time of the intercorporate liquidation in case control was not acquired by the transferee), the basis of the aggregate assets of the transferor attributable to stock owned by the transferee with a cost basis is to be revalued to accord with such cost basis. See section 761 (c). Distributions from earnings and profits of the transferor between the date of acquisition of such stock and the date of acquisition of control (or the time of the intercorporate liquidation in case control was not acquired) may have the effect of reducing the assets of the transferor properly subject to revaluation. For the purpose of section 761 in the case of such distributions made with respect to stock having a cost basis, the basis of such stock shall be reduced by an amount proper to give effect to any such reduction in assets.

(f) *Postcontrol distributions in case of cost basis stock.* If the stock of the transferor is deemed to have a cost basis to the transferee, the adjusted basis of the assets of the transferor must be recomputed pursuant to the provisions of section 761 (c) (1) and § 35.761–5 (a). A subsequent sale or other disposition of the assets of the transferor involved in such recomputation, or the use of such assets in the trade or business of the transferor will affect the earnings and profits of the transferor in amounts determined by reference to the recomputed basis. In determining whether a distribution made by the transferor to the transferee after the acquisition of control by the transferee of the transferor is a dividend within the meaning of section 115 (a) or a distribution in reduction of the basis of the stock of the transferor under section 113 (b) (1) (D) for the purposes of the computation of the adjusted basis of such stock to be used in the computation of the plus adjustment or the minus adjustment under section 761 (b), the earnings and profits of the transferor recomputed in accordance with the method prescribed in this subsection shall be used in lieu of the earnings and profits of the transferor otherwise determined.

§ 35.761–5 *Basis of property received in an intercorporate liquidation with respect to stock having a cost basis*—(a) *Determination.* For the purpose of determining the plus adjustment or the minus adjustment to be used in adjusting the equity invested capital of a transferee in an intercorporate liquidation pursuant to section 761 (b) and (d), the property received by a transferee in an intercorporate liquidation attributable to a share of stock of the transferor having in the hands of the transferee a basis determined under § 35.761–3 to be a cost basis shall be considered to have at the time so received an adjusted basis determined as follows:

(1) *Basis of property with respect to stock acquired on or before date of acquisition of control of transferor.* With respect to a share of stock of the transferor acquired by the transferee with a cost basis on or before the date of acquisition by the transferee of control of the transferor, the aggregate of the property (other than money) held by the transferor at the time of the acquisition by the transferee of control of the transferor shall be considered to have an aggregate basis equal to the amount determined by:

(i) Multiplying the amount of the adjusted basis of such share in the hands of the transferee at the time of acquisition of control by the aggregate number of share units in the transferor at such time, the interest represented by such share being taken as the share unit,

(ii) Adding to the amount determined under (i) the amount of the liabilities of the transferor at the time of acquisition of control, and

(iii) Subtracting from the sum of the amounts determined under (i) and (ii) the amount of money on hand in the transferor at the time of acquisition of control.

(2) *Basis of property with respect to stock acquired after acquisition of control of transferor.* If a share of stock of the transferor was acquired by the transferee with a cost basis after the transferee acquired control of the transferor, the aggregate basis of the property of the transferor (other than money) held by the transferor at the time of the acquisition by the transferee of such share of the transferor shall be determined in the manner prescribed in (1), except that such computation shall be made as of the time of the acquisition of such share. A share of stock shall be considered to have been acquired after the transferee acquired control of the transferor only if, after the acquisition of such share, the transferee did not lose control of the transferor. A share of stock shall be considered to have been acquired on or before the date of acquisition of control if, after the acquisition of such share,

the transferee lost control previously held in the transferor and subsequently reacquired and retained control until the time of the intercorporate liquidation.

(3) *Basis of property with respect to stock in transferor in which control is not acquired.* If a share of stock is owned in a transferor and if immediately prior to the receipt of any property in the intercorporate liquidation in respect of such share the transferee does not have control of the transferor, the aggregate basis of the property of the transferor shall be determined in the manner prescribed in (1), except that such computation shall be made as of the time immediately prior to the receipt of the property in the intercorporate liquidation.

(4) *Redetermination of basis of property to accord with basis of stock.* The amount determined under (1), (2), or (3) of this paragraph, representing the aggregate basis of the property of the transferor at the time of acquisition of control of the transferor, at the time of acquisition of stock of the transferor subsequent to the acquisition of control, or at the time of the intercorporate liquidation may be greater or less than the amount of the aggregate adjusted basis of the property of the transferor at such time otherwise computed. Ordinarily, if:

(i) The aggregate basis of the property of the transferor determined under (1), (2), or (3) of this paragraph exceeds the aggregate adjusted basis of such property otherwise computed, such excess shall be deemed to be the basis of an asset which, for the purposes of section 761, shall be called "positive good will," or

(ii) The aggregate basis of the property of the transferor determined under (1), (2), or (3) of this paragraph is less than the aggregate adjusted basis of such property otherwise computed, such difference shall be deemed to represent a deduction from the aggregate basis of the property of the transferor otherwise computed; such difference shall be represented in a credit account to be called "negative good will."

If the fair market value of the property of the transferor at the time as of which the recomputation is made is greater or less than the aggregate adjusted basis of such property determined without regard to (1), (2), or (3) of this paragraph, proper adjustment shall be made to the basis of such assets to reflect such difference.

(5) *Basis of property acquired by transferor subsequent to determination of basis under (4).* In any case in which the transferor, subsequent to the date as of which the redetermination of the basis of its property has been made pursuant to (4) of this paragraph, acquires additional property, the basis of which is fixed by reference to the basis of the property redetermined under (4) of this paragraph, the basis of such additional property shall be determined with respect to the basis of such property redetermined in accordance with the rules set forth in (4) of this paragraph in lieu of the basis otherwise prescribed with respect to such property.

(6) *Use of basis determined for subsequent adjustments.* The basis of the property determined under (4) or (5) of this paragraph shall be used in determining, for the purposes of section 761, all subsequent adjustments to the basis of such property, as, for example, the adjustment based upon depreciation or depletion. Such basis shall also be used in lieu of the basis otherwise prescribed by section 113 in determining, for the purposes of section 761, the gain or loss resulting from a sale or other disposition of such assets by the transferor. The adjustments so obtained and the amount of gain or loss resulting from a sale or other disposition of such assets so determined shall, for the purposes of section 761, be used in computing the earnings and profits or the deficit in earnings and profits of the transferor to ascertain:

(i) Whether distributions subsequent to the date as of which the aggregate basis of the assets of the transferor is determined with respect to stock having a cost basis are out of earnings and profits of the transferor;

(ii) The amount to be included in the earnings and profits of the transferee as a result of such distributions out of earnings and profits of the transferor; or

(iii) The adjustment to be made to the basis of the stock of the transferor owned by the transferee resulting from any such distributions not out of earnings and profits of the transferor.

(7) *Property received by transferee in intercorporate liquidation.* The property received by the transferee in an intercorporate liquidation attributable to a share of stock of the transferor having a cost basis shall be considered to have, at the time of its receipt by the transferee in the intercorporate liquidation, a basis determined as follows:

(i) With respect to property so received which was owned by the transferor with a basis not determined by reference to this paragraph, for example, property the basis of which had not been increased or decreased in a revaluation under (4) of this paragraph or property acquired subsequent to the date of such revaluation, such property shall have the same basis to the transferee which it had in the hands of the transferor immediately prior to the intercorporate liquidation, adjusted, however, by adjustments proper under section 115 (l) for the determination of earnings and profits

(ii) With respect to property so received which was owned by the transferor with a basis increased or decreased as the result of a recomputation provided by (4) of this paragraph, and with respect to property so received which had a basis fixed, as provided by (5) of this paragraph, by reference to other property the basis of which was recomputed pursuant to the provisions of (4) of this paragraph, such property shall have the same basis to the transferee which it had in the hands of the transferor, so increased or decreased, immediately prior to the intercorporate liquidation, adjusted, however, by adjustments proper under section 115 (l) for the determination of earnings and profits; only such part of the aggregate property received by the transferee in the intercorporate liquidation as is attributable to the share of stock with a cost basis shall be considered as having the recomputed basis which such property is deemed to have under (4) or (5) of this paragraph.

(b) *Control.* For the purposes of this section, "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the ownership of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and shall be determined under the following rules:

(1) Control must be continued under the completion of the intercorporate liquidation.

(2) If control is lost and later reacquired (except as otherwise provided in (3)), the date of the last acquisition of control shall be considered to be the date of acquisition of control.

(3) If control, once acquired, was lost because stock of the transferor which did not possess voting power at the time such control was acquired became entitled to vote, and if control was reacquired either because the stock which became entitled to vote lost its voting power or through the acquisition of the requisite portion of such stock, and such control continues until the completion of the intercorporate liquidation, the date of acquisition of control shall be the date upon which control was first acquired.

(4) Except as otherwise provided in (6), if stock of a corporation was acquired from another corporation which had held such stock with a cost basis, and if such stock is determined to have a cost basis in the hands of the acquiring corporation fixed by reference to its basis in the hands of such other corporation, the acquiring corporation shall be deemed to have acquired such stock as of the date upon which such stock was acquired by such other corporation.

(5) If stock of a corporation was acquired from another corporation in a liquidation subject to the provisions of section 112 (b) (6), or the corresponding provisions of a prior revenue law, and if the stock of the liquidated corporation was held by the acquiring corporation with a cost basis but the stock acquired was held by the liquidated corporation with a basis other than cost, the acquiring corporation shall be deemed to have acquired the stock received in the liquidation as of the date upon which it had acquired the stock of the liquidated corporation.

(6) If stock of a corporation was acquired from another corporation in a liquidation subject to the provisions of section 112 (b) (6), or the corresponding provisions of a prior revenue law, and if the stock so acquired was held by the liquidated corporation and the stock of the liquidated corporation was held by the acquiring corporation, both with a cost basis, the acquiring corporation shall be deemed to have acquired the stock received in the liquidation as of the date upon which such stock was acquired by the liquidated corporation, or

as of the date upon which the acquiring corporation acquired the stock of the liquidated corporation with respect to which the distribution was made, whichever date was the later.

(7) If stock of a corporation was acquired with a basis determined to be a cost basis under § 35.761–3 (b) (1) because the basis of such stock was fixed by reference to the cost basis of other stock in the hands of the acquiring corporation, the acquiring corporation shall be deemed to have acquired such stock as of the date upon which it had acquired such other stock.

(8) If the basis of the stock of a transferor in the hands of the transferee was increased as the result of a statutory merger or consolidation of the transferor and another corporation, or as the result of a transaction having the effect of a statutory merger or consolidation, and if the stock of such other corporation was held by the transferee with a cost basis, that portion of the transferee's stockholding interest in the transferor represented by the increase shall be deemed to have been acquired as of the date upon which the transferee had acquired the stock of such other corporation.

§ 35.761–6 *Basis of property received in an intercorporate liquidation with respect to stock having a basis other than cost.* For the purpose of determining the plus adjustment or the minus adjustment to be used in adjusting the equity invested capital of a transferee in an intercorporate liquidation pursuant to section 761 (b) and (d), the property received by a transferee in an intercorporate liquidation attributable to a share of stock of the transferor having in the hands of the transferee a basis determined under § 35.761–3 to be a basis other than cost shall be considered to have at the time so received by the transferee the basis it would have had if the first sentence of section 113 (a) (15) had been applicable, i. e., the basis of such property to the transferee shall be the basis which such property had in the hands of the transferor, adjusted by adjustments proper under section 115 (l) in determining earnings and profits. Such basis shall be used for the purposes of section 761 in lieu of the basis for determining gain or loss upon a sale or other disposition prescribed by any provision or rule of law such as the last sentence of section 113 (a) (15), or the corresponding provisions of a prior revenue law, or § 33.38 (c) (3) of this chapter or section 23.38 (c) (3) of Regulations 104 or corresponding sections of prior consolidated returns regulations. Only such part of the aggregate property of the transferor received by the transferee in the intercorporate liquidation as is attributable to a share having a basis determined to be a basis other than cost shall be considered as having the adjusted basis which property is deemed to have under section 761 (c) (2) and this section. Thus, if the aggregate basis of the assets to the transferor, properly adjusted by the adjustments required by section 115 (l) is $400,000, and if the transferee owns 90 percent of the stock of the transferor half of which was held with a basis other than cost, and receives 90 percent of the aggregate property of the transferor upon the intercorporate liquidation, the aggregate basis of the assets received by the transferee with respect to the shares held with a basis other than cost, for the purposes of section 761, is $180,000 (one-half of 90 percent of $400,000).

§ 35.761–7 *Adjustment of equity invested capital.* If property is received by the transferee in an intercorporate liquidation within the meaning of section 761 (a), the equity invested capital of the transferee for any day following the day in which such intercorporate liquidation is completed shall be computed with the following adjustments:

(a) *Adjustment with respect to stock with cost basis.* With respect to any share of stock in the transferor having in the hands of the transferee, immediately prior to the receipt of the property in the intercorporate liquidation, a basis determined under the provisions of § 35.761–3 to be a cost basis, the earnings and profits or the deficit in earnings and profits of the transferee shall be computed as if, on the day following the completion of the intercorporate liquidation, the transferee had realized a recognized gain equal to the amount of the plus adjustment in respect of such share or had sustained a recognized loss equal to the amount of the minus adjustment in respect of such share, computed under the provisions of section 761 (b) and § 35.761–2. No other amount shall be included pursuant to any provision or rule of law in the earnings and profits of the transferee as a result of the intercorporate liquidation with respect to such share.

(b) *Adjustment with respect to stock with basis other than cost.* With respect to any share of stock in the transferor having in the hands of the transferee, immediately prior to the receipt of the property in the intercorporate liquidation, a basis determined under the provisions of § 35.761–3 to be a basis other than cost, there shall be treated as an amount includible in the sum specified in section 718 (a) (relating to equity invested capital) for each day following the intercorporate liquidation the amount of the plus adjustment computed with respect to such share under section 761 (b) and § 35.761–2 (a), or as an amount includible in the sum specified in section 718 (b) (relating to reduction in equity invested capital) for each day following the intercorporate liquidation the amount of the minus adjustment computed with respect to such share under section 761 (b) and § 35.761–2 (b).

(c) *Illustration.* The provisions of section 761 may be illustrated by the following example:

Assume that Corporation S was organized on December 31, 1928, with an authorized capital stock of $25,000 consisting of 1,000 shares of common stock with a par value of $25 per share. On that date, in a transaction within the provisions of section 112 (b) (5) of the Revenue Act of 1928, Corporation S issued to Corporation P 600 shares of its stock in exchange for a patent which had an adjusted basis to P of $15,000, and 400 shares of its stock to individuals in exchange for property with an adjusted basis to such individuals of $10,000. The basis to P of the 600 shares of stock of S is determined to be a basis other than cost. Section 113 (a) (6) and § 35.761–3 (b) (1). On December 31, 1931, P purchased for $80,000 in cash the remaining 400 shares of the stock of S which it retained until the liquidation of S on December 31, 1936, under section 112 (b) (6) of the Revenue Act of 1936, an intercorporate liquidation. The date of acquisition of control of S by P was December 31, 1931. § 35.761–5 (b). On December 31, 1928, the patent acquired by S had a remaining life of 15 years; on December 31, 1931, the date of acquisition of control of S by P, the patent had a fair market value of $72,000. As of December 31, 1931, the fair market value of the remaining assets of S was identical with their adjusted basis.

Comparative balance sheets of S as of December 31, 1931, the date of acquisition of control by P, and as of December 31, 1936, the date of liquidation of S, are as follows:

	December 31, 1931		*December 31, 1936*
Assets:			
Cash	$5,000		$35,000
Current assets	60,000		120,000
Fixed assets (less depreciation)	30,000		130,000
Patent	$15,000	$15,000	
Less: Reserve for amortization	3,000	8,000	
	12,000		7,000
Total assets	107,000		292,000
Liabilities and capital:			
Current liabilities	$12,000		$22,000
Mortgage on fixed assets	15,000		10,000
Capital stock	25,000		25,000
Surplus (earnings and profits)	55,000		235,000
	107,000		292,000

The plus adjustment or the minus adjustment to be made to the invested capital of P resulting from the intercorporate liquidation of S is a direct addition to or subtraction from the equity invested capital of P with respect to the stock of S held with a basis other than cost (section 761 (d) (2)); it is deemed to be a recognized gain or loss to P as of the day following the intercorporate liquidation with respect to the stock of S held with a cost basis (section 761 (d) (1)). Moreover, the determination of the basis of property received with respect to stock held with a basis other than cost (section 761 (c) (2)) differs from the determination of such basis with respect to stock held with a cost basis (section 761 (c) (1)). Two separate computations must therefore be made.

(1) *Stock with a basis other than cost.* With respect to the 600 shares of stock of S held by P with a basis other than cost, P is deemed to have received 60 percent $\left(\frac{600}{1000}\right)$ of the assets and to have assumed 60 percent of the liabilities of S, as follows:

	Total assets	Assets received
Cash	$35,000	$21,000
Current assets	120,000	72,000
Fixed assets (less depreciation)	130,000	78,000
Patent	$15,000	$9,000
Less: Reserve for amortization	8,000	4,800
	7,000	4,200
Total	292,000	175,200

	Total liabilities	Liabilities assumed
Current liabilities	$22,000	$13,200
Mortgage on fixed assets	10,000	6,000
Total	32,000	19,200

There is a plus adjustment to the equity invested capital of P in the amount of $141,000 computed as follows:

Money received by P	$21,000	
Adjusted basis of all other property received by P	154,200	
Total assets received		$175,200
Less: Adjusted basis of P to 600 shares of stock of S	$15,000	
Aggregate liabilities assumed	19,200	
Total		34,200
Plus adjustment		141,000

(2) *Stock with a cost basis.* With respect to the 400 shares of stock of S held by P with a cost basis, the basis of the aggregate property of S is to be recomputed, as of December 31, 1931, the date of acquisition by P of control of S, to accord with the basis of such stock (section 761 (c) (1) (A)), as follows:

Cost basis per share of stock ($80,000 divided by 400)		$200
Number of share units		1,000
Product of cost per share and number of share units		$200,000
Less: Money		5,000
Difference		195,000
Add: Liabilities:		
Current liabilities	$12,000	
Mortgage on fixed assets	15,000	
		27,000
Basis of aggregate property other than money		222,000

The excess of the recomputed basis of the aggregate property of S, other than money, over the adjusted basis of such property prior to the recomputation is $120,000 ($222,000 minus $102,000). The only asset which had a fair market value in excess of its adjusted basis prior to the recomputation is the patent. In the recomputation, the basis of the patent is increased by $60,000 under section 761 (c) (1) (A) to its fair market value of $72,000. The remainder of the excess of the recomputed basis of the aggregate property of S other than money over the adjusted basis of such property prior to the recomputation ($120,000 minus $60,000) becomes the basis of an account entitled "Positive good will."

As of December 31, 1931, the adjusted basis and the recomputed basis of the property of S would appear as follows:

Assets:	Adjusted basis		Recomputed basis
Cash	$5,000		$5,000
Current assets	60,000		60,000
Fixed assets (less depreciation)	30,000		30,000
Patent	$15,000	$75,000	
Less: Reserve for amortization	3,000	3,000	
	12,000		72,000
Positive good will			60,000
	107,000		227,000

Pursuant to section 761 (c) (1) (C), the recomputed basis of the patent is to be used in determining all subsequent adjustments to the basis of such asset. Thus, for each of the five years between December 31, 1931, and December 31, 1936, the date of the intercorporate liquidation, the patent will be amortized at $6,000 per year ($72,000 divided by 12), instead of $1,000 per year ($15,000 divided by 15). The total amount included in the reserve for amortization will be $33,000 ($3,000 plus $30,000) instead of $8,000 ($3,000 plus $5,000). As of December 31, 1936, P is deemed to have received with respect to the 400 shares of stock of S held with a cost basis 40 percent $\left(\frac{400}{1000}\right)$ of the assets of S, including the positive good will account, revalued according to section 761 (c) (1) (A) and (C), and to have assumed 40 percent of the liabilities of S. (Section 761 (c) (1) (E).) The adjusted basis of the property of S as of December 31, 1936, prior to the recomputation and as recomputed, and the portion of the assets deemed to have been received and the liabilities deemed to have been assumed by P, are as follows:

Assets	Prior to recomputation		As recomputed		Assets received
Cash		$35,000		$35,000	$14,000
Current assets		120,000		120,000	48,000
Fixed assets (less depreciation)		130,000		130,000	52,000
Patent	$15,000		$75,000		$30,000
Less: Reserve for amortization	8,000		33,000		13,200
		7,000		42,000	16,800
Positive good will				60,000	24,000
Total		292,000		387,000	154,800

Liabilities:	Total liabilities	Liabilities assumed
Current liabilities	$22,000	$8,800
Mortgage on fixed assets	10,000	4,000
Total	32,000	12,800

There is a plus adjustment deemed to be a recognized gain to P as of January 1, 1937, in the amount of $62,000, computed as follows:

Money received by P	$14,000	
Adjusted basis of all other property received by P	140,800	
Total assets received		$154,800
Less: Adjusted basis to P of 400 shares of stock of S	$80,000	
Aggregate liabilities assumed	12,800	
Total		92,800
Plus adjustment		62,000

The unadjusted basis to P of the property from S in the intercorporate liquidation is computed as follows:

	Basis with respect to 600 shares	Basis with respect to 400 shares	Total
Cash	$21,000	$14,000	$35,000
Current assets	72,000	48,000	120,000
Fixed assets (less depreciation)	78,000	52,000	130,000
Patent	$9,000	$30,000	$39,000
Less: Reserve for amortization	4,800	13,200	18,000
	4,200	16,800	21,000
Positive good will		24,000	24,000
Total	175,200	154,800	330,000

For the purpose of computing the earnings and profits and the adjusted basis of the patent received from S in the intercorporate liquidation to be used in the determination of the invested capital of P for each excess profits tax taxable year, the patent would be deemed to have an unadjusted basis to P of $21,000 as of January 1, 1937, and the annual amount of amortization from that date would be $3,000 ($21,000 divided by 7) instead of $1,000, the amount of amortization taken by S.

§ 35.761–8 *Invested capital basis.* For the purpose of computing any amount entering into the computation of the invested capital of the transferee, or of any other corporation the computation of the invested capital of which is determined by reference to the basis of property in the hands of the transferee, the adjusted basis which property received by the transferee in an intercorporate liquidation is deemed to have at the time of its receipt by the transferee, determined under section 761 (c) and § 35.761–5, shall be thereafter treated as the adjusted basis of such property in lieu of any other basis otherwise prescribed. Thus, items of depreciation or depletion or any other items computed by reference to the basis of property received in an intercorporate liquidation shall, for the purpose of computing the invested capital of the transferee, be determined by reference to the adjusted basis of such property in the hands of the transferee computed under section 761 in lieu of any basis prescribed by section 113 or any other provision or rule of law. Likewise, the adjusted basis of stock or other assets received by the transferee in an intercorporate liquidation shall, for the purpose of determining the ratio of inadmissible assets to total assets under section 720 (b), be the adjusted basis as provided in section 761 (c) in lieu of the basis determined under section 113. So, also, for the purpose of determining the earnings and profits resulting from a sale or other disposition of an asset received in an intercorporate liquidation the adjusted basis of such asset shall be the adjusted basis as provided in section 761 (c).

Post-War Refund of Excess Profits Tax[1]

SEC. 780. POST-WAR REFUND OF EXCESS PROFITS TAX. [Added by sec. 250, Rev. Act 1942; amended by sec. 2, Public Law 21 (Seventy-eighth Congress).]

(a) *In general.* The Secretary of the Treasury is authorized and directed to establish a credit to the account of each taxpayer subject to the tax imposed under this subchapter, for each taxable year ending after December 31, 1941 (except in the case of a taxable year beginning in 1941 and ending before July 1, 1942), and not beginning after the date of cessation of hostilities in the present war, of an amount equal to 10 per centum of the tax imposed under this subchapter for each such taxable year. For the purposes of this part, in the case of a taxpayer whose tax is determined under section 710 (a) (3), the term "tax imposed under this subchapter" means the excess of the tax imposed by such section 710 (a) (3) over the tax that would be imposed if such section 710 (a) (3) were not applicable.

(b) *Application of credit to purchase of bonds.* Within three months after the payment of the amount of the excess profits tax shown on the return for a taxable year to which subsection (a) applies (or, if such taxable year begins or ends in 1942, within one year after payment of the excess profits tax shown on the return for such year), if the payment is made before three months before the date of maturity of bonds for such year under subsection (c), there shall be issued to and in the name of the taxpayer bonds of the United States in an aggregate amount equal to 10 per centum of the tax paid in respect of which a credit is provided under subsection (a), and the credit established under subsection (a) for such taxable year is hereby made available for the purchase of such bonds.

(c) *Terms and maturity of bonds.* The bonds provided for in subsection (a) shall be issued under the authority and subject to the provisions of the Second Liberty Bond Act, as amended, and the purposes for which bonds may be issued under such Act are extended to include the purposes for which bonds are required to be issued under this section. Such bonds shall bear no interest, shall be nonnegotiable, and shall not be transferable by sale, exchange, assignment, pledge, hypothecation, or otherwise, on or before the date of cessation of hostilities in the present war, but after said date, such bonds shall be negotiable, and may be sold, exchanged, pledged, assigned, hypothecated, or otherwise transferred, without restriction, and shall be redeemable (at the option of the United States) in whole or in part upon three months' notice. Such bonds for any taxable year to which this section applies shall mature on the last day of that calendar year, beginning after the date of cessation of hostilities in the present war, which is shown in the following table to be applicable to such bonds for such year:

Bonds purchased with the credit for any taxable year beginning—	*Calendar year (beginning after cessation of hostilities) on last day of which bonds mature*
Within the calendar year 1941 or 1942	2nd
Within the calendar year 1943	3rd
Within the calendar year 1944	4th
After December 31, 1944	5th

(d) *Exemption of proceeds from tax.* The proceeds of any such bond upon redemption shall not be included in gross income.

(e) *Date of cessation of hostilities in the present war.* As used in this section, the term "date of cessation of hostilities in the present war" means the date on which hostilities in the present war between the United States and the governments of Germany, Japan, and Italy cease, as fixed by proclamation of the President or by concurrent resolution of the two Houses of Congress, whichever date is earlier, or in case the hostilities between the United States and such governments do not cease at the same time, such date as may be so fixed as an appropriate date for the purposes of this section.

§ 35.780–1 *Post-war refund of excess profits tax.*—(a) *In general.* Section 780 (a) authorizes and directs the Secretary to establish a post-war credit, for each taxable year specified in such section, to the account of each taxpayer subject to excess profits tax. The taxable years so specified include all taxable years under this part which begin on or before the "date of cessation of hostilities in the present war," as defined in section 780 (e).

The post-war credit accounts of taxpayers subject to excess profits tax shall be maintained by the Commissioner of Internal Revenue.

Subject to the limitations prescribed in section 731 (d) (see § 35.781–1 (b)), the post-war credit of a taxpayer for a taxable year is an amount equal to 10 percent of the excess profits tax imposed upon the taxpayer for such year. For such purpose the tax imposed is the amount of tax determined under Subchapter E of Chapter 2 prior to (1) any credit under section 131, as made applicable by section 729, for tax paid or accrued to a foreign country or possession of the United States, (2) any credit for debt retirement under section 783, and (3) any adjustment under section 734 on account of position inconsistent with prior income tax liability. If it is determined, in the case of any taxpayer with respect to any taxable year, that constructive average base period net income should be used pursuant to section 722 in computing its tax, the tax imposed, for the purpose of the post-war credit for such year, is the amount determined pursuant to the preceding sentence after the determination pursuant to such section. But in such case, pending the final determination of the tax pursuant to section 722, the tax imposed shall, for such purpose, be tentatively considered as an amount determined without regard to the determination under section 722, minus the amount, if any, by which the tax payable at the time prescribed for payment is reduced under section 710 (a) (5) (relating to deferment of payment of tax in case of claim under section 722). For the purpose of the post-war credit, the tax imposed does not include any interest, penalty, additional amount, or addition to the tax.

For provisions relating to reduction of the post-war credit on account of the allowance of a credit for debt retirement, see section 783 (c) and § 35.783–1 (c).

(b) *Bonds.* Section 780 (b) relates to the application of the post-war credit to the purchase of bonds of the United States. Section 780 (c) relates to the

[1] Part III, sections 780–783 of the Internal Revenue Code.

terms and maturity of such bonds. The Commissioner of Internal Revenue shall certify to the Secretary statements of the amounts of post-war credit when such amounts are determined. The issuance, transfer, and redemption of bonds, and other matters relating to the bonds (as distinguished from the determination and adjustment of amounts of post-war credits and the maintenance of post-war credit accounts), are within the jurisdiction of the Secretary to be handled through the office of the Commissioner of the Public Debt, not the Commissioner of Internal Revenue.

For provisions relating to reduction of the amount of bonds on account of the allowance of a credit for debt retirement, see section 783 (c) and § 35.783–1 (c).

(c) *Exemption of proceeds of bonds from tax.* The proceeds of bonds upon redemption which are issued under section 780 shall not be included in gross income.

SEC. 781. SPECIAL RULES FOR APPLICATION OF SECTION 780. [Added by sec. 250, Rev. Act 1942.]

(a) *Effect of deficiencies.* If a deficiency in respect of the excess profits tax for any taxable year for which a credit is provided in section 780 (a) is paid by the taxpayer before three months before the date of maturity of the bonds for such year, an amount of such credit equal to 10 per centum of the excess of the tax imposed by this subchapter on the basis of which the deficiency was determined, over the tax imposed by this subchapter as previously computed and paid shall be available, as provided in section 780 (b), for the purchase of bonds as provided under such section, and there shall be issued to the taxpayer bonds under such section in an amount equal to such excess and with the same maturity as in the case of bonds issued with respect to the taxable year with respect to which the deficiency is determined.

(b) *Effect of refunds.* If an overpayment of the tax imposed by this subchapter for any taxable year for which a credit is provided in section 780 (a) is refunded or credited to the taxpayer under the internal revenue laws, the credit, if any, provided in such section then existing in favor of the taxpayer shall be reduced by an amount equal to 10 per centum of the excess of the tax imposed by this subchapter on the basis of which such tax (in respect of which the internal revenue refund or credit was made) was previously computed and paid, over the tax imposed by this subchapter as determined in connection with the determination of the amount of the overpayment. In such a case, if such credit provided in section 780 (a) is less than the amount by which it is required to be reduced, or if there is no such credit then existing in favor of the taxpayer, the excess of such amount over the amount of such credit, if any, shall be carried forward as a charge against the taxpayer to be applied in reduction of a subsequent credit under section 780 (a); and if no such subsequent credit is made in favor of the taxpayer, the amount of such charge (without interest) shall be paid by the taxpayer to the United States or the amount of bonds previously issued to the taxpayer under section 780 (b) shall be adjusted on account of such charge.

(c) *Tax payments after cut-off date.* In the case of a payment of the tax imposed by this subchapter shown on the return for any taxable year for which a credit is provided in section 780 (a), or the payment of a deficiency in respect of such tax for any such taxable year, after the date prescribed in section 780 (b) or 781 (a) but before the date of maturity of the bonds with respect to such taxable year under section 780 (c), the amount of the credit under section 780 (a) for such taxable year attributable to such payment shall, so far as practicable, be available, as provided in section 780 (b), for the purchase of bonds as provided under such section, and, so far as practicable, there shall be issued to the taxpayer bonds under such section with the same maturity as bonds issued with respect to such taxable year. To the extent that it is not practicable to issue bonds against such amount of the credit, the taxpayer shall be paid in cash. In case after the date of maturity of the bonds of any taxable year under section 780 (c) there is any credit under section 780 (a) remaining in favor of the taxpayer, attributable to such year, such remainder shall be paid to the taxpayer in cash. No amount of any payment made under this subsection to a taxpayer shall be included in gross income.

(d) *Limitation.* The credit under section 780 (a) for any taxable year shall not be greater than the excess of the amount of the tax paid under this subchapter to the United States (and not credited or refunded under the internal revenue laws) in respect of such year over the amount of tax which would be payable to the United States if the excess profits tax rate were 81 per centum, or if the limitation of section 710 is applicable if the amount determined under such section were reduced by 10 per centum.

§ 35.781–1 *Special rules for application of section 780—(a) Deficiencies; refunds and credits of overpayments.* In case a deficiency is paid by the taxpayer, or an overpayment is refunded or credited to the taxpayer, for any taxable year to which section 780 (a) applies, appropriate adjustments will be made in the post-war credit account of the taxpayer. In such case, whenever the amount of bonds should be increased or reduced, the Commissioner of Internal Revenue shall certify the status of the account to the Secretary in order that appropriate adjustments may be made in the amount of bonds. Collection from a taxpayer under section 781 (b) of the amount by which charges (arising by reason of a refund or credit of an overpayment) exceed the amount of the post-war credit of the taxpayer, and payment to a taxpayer under section 781 (c) of amounts of any outstanding post-war credit against which bonds have not been issued, shall be made by the Commissioner of Internal Revenue. Such payments to taxpayers under section 781 (c) shall not be included in gross income.

(b) *Limitations on amount of post-war credit.* The post-war credit provided for in section 780 (a) (see § 35.780–1 (a)) is subject to the limitations set forth in section 781 (d). The limitations operate in certain cases in which the taxpaper takes a credit against excess profits tax, pursuant to section 131, as made applicable by section 729, for tax paid or accrued to a foreign country or United States possession. They operate also to eliminate or reduce the post-war credit in case the excess profits tax is not paid, or is not paid in full, and in certain cases in which the excess profits tax is reduced by an adjustment under section 734 on account of position inconsistent with prior income tax liability (as, for example, if the amount of such reduction exceeds the amount of excess profits tax that would be payable if the excess profits tax rate were 81 percent). The limitations are as follows:

(1) The post-war credit is provided only with respect to excess profits tax paid (and not credited or refunded under the internal revenue laws). (See example (1), below.)

(2) The post-war credit for any taxable year, other than a taxable year to which section 710 (a) (1) (B) is applicable, shall not be greater than the excess of the excess profits tax paid over the amount which would be payable if the excess profits tax rate were 81 percent. (See examples (1) and (2), below.)

(3) In the case of any taxable year to which section 710 (a) (1) (B) is applicable (limiting excess profits tax to an amount which, when added to normal tax and surtax, equals 80 percent of corporation surtax net income before the credit for income subject to excess profits tax provided in section 26 (e)), the post-war credit for such year shall not be greater than the excess of the excess profits tax paid over the amount which would be payable if the amount determined under section 710 (a) (1) (B) were reduced by 10 percent. (See example (3), below.)

For the purpose of the limitations prescribed in section 781 (d), the amount of credit for debt retirement allowed under section 783, if any, shall be considered as an amount of tax paid; and for such purpose, in determining amounts of tax which would be payable under the conditions prescribed in section 781 (d), such amounts shall be determined without regard to any credit for debt retirement.

The application of section 781 (d) may be illustrated by the following examples:

Example (1). The X Corporation has for the calendar year 1942 an adjusted excess profits net income of $1,000,000, which is subject to the excess profits tax rate of 90 percent. The excess profits tax imposed is $900,000 (90 percent of $1,000,000), of which only $850,000 is actually paid. The post-war credit of the corporation under section 780 (a) computed without regard to the limitation provided in section 781 (d) would be $90,000 (10 percent of $900,000). However, such credit is limited by section 781 (d) to $40,000, computed as follows:

Excess profits tax paid	$850,000
Less excess profits tax payable if rate were 81 percent (81 percent of $1,000,000)	810,000
Post-war credit allowable	40,000

Example (2). The normal-tax net income, surtax net income, and excess profits net income of the X Corporation, a domestic corporation, for the calendar year 1942 is $1,000,000, of which $200,000 is from sources within a foreign country and $800,000 from sources within the United States. The amount of the normal-tax net income and of the surtax net income is stated hereinbefore without regard to the credit for income subject to excess profits tax provided in section 26 (e). The corporation pays to the foreign country with respect to the calendar year 1942 income tax in the amount of $160,000 upon income from sources therein. After allowance of the credit against normal tax and surtax for foreign tax, the amount of $136,000 of the foreign tax is available as a credit against the excess profits tax for 1942. Such credit is limited by section 729 to one-fifth of the corporation's ex-

cess profits tax for that year since only one-fifth of its entire excess profits net income is from sources within the foreign country. The excess profits credit of the corporation for 1942 under section 712 is $295,000, and its specific exemption under section 710 (b) is $5,000. The corporation pays its excess profits tax for 1942 in full. The post-war credit of the corporation for that year is $50,400, computed as follows:

Excess profits net income		$1,000,000
Less:		
Specific exemption	$5,000	
Excess profits credit	295,000	
		300,000
Adjusted excess profits net income		700,000
Excess profits tax imposed (90 percent of $700,000)		630,000
Less foreign tax credit (⅕ of $630,000)		126,000
Excess profits tax determined under section 710		504,000
Post-war credit under section 780 (a) computed without regard to the limitation under section 781 (d) (10 percent of $630,000 (tax imposed))		63,000
Limitation under section 781 (d)		
Excess profits tax paid		$504,000
Less excess profits tax payable if rate were 81 percent:		
Tax at 81-percent rate (81 percent of $700,000)	$567,000	
Less foreign tax credit (⅕ of $567,000)	113,400	
		453,600
Limitation under section 781 (d)		50,400
Post-war credit allowable		50,400

Since the post-war credit under section 780 (a) ($63,000) computed without regard to the limitation under section 781 (d) is greater than the amount ($50,400) determined under section 781 (d), the amount determined under section 781 (d) is the amount of the post-war credit.

Example (3). The facts are the same as in example (2) except that the excess profits credit of the X Corporation under section 712 is $95,000 instead of $295,000 and the amount of the foreign tax available as a credit against the corporation's excess profits tax, after allowance of the credit against normal tax and surtax for foreign tax, is $152,000 instead of $136,000. The post-war credit of the X Corporation for the calendar year 1942 is $60,800, computed as follows:

Excess profits net income		$1,000,000
Less:		
Specific exemption	$5,000	
Excess profits credit	95,000	
		100,000
Adjusted excess profits net income		900,000
Excess profits tax determined under section 710 (a) (1) (A) (90 percent of $900,000)		810,000
Normal-tax net income before credit for adjusted excess profits net income		1,000,000
Less credit for adjusted excess profits net income		900,000
Normal-tax net income		100,000
Normal tax (24 percent of $100,000)		24,000
Surtax net income before credit for adjusted excess profits net income		1,000,000
Less credit for adjusted excess profits net income		900,000
Surtax net income		100,000
Surtax (16 percent of $100,000)		16,000
Limitation under section 710 (a) (1) (B): 80 percent of surtax net income before credit for adjusted excess profits net income (80 percent of $1,000,000)		800,000
Less:		
Normal tax	$24,000	
Surtax	16,000	
		40,000
Excess profits tax determined under section 710 (a) (1) (B)		760,000
Less foreign tax credit (⅕ of $760,000)		152,000
Excess profits tax determined under section 710		608,000
Post-war credit under section 780 (a) computed without regard to the limitation under section 781 (d) (10 percent of $760,000 (tax imposed))		76,000
Limitation under section 781 (d)		
Excess profits tax paid		$608,000
Less amount of excess profits tax determined under section 710 reduced by 10 percent ($608,000 minus $60,800)		547,200
Limitation under section 781 (d)		60,800
Post-war credit allowable		60,800

Since the post-war credit under section 780 (a) ($76,000) computed without regard to the limitation under section 781 (d) is greater than the amount ($60,800) determined under section 781 (d), the amount determined under section 781 (d) is the amount of the post-war credit.

SEC. 782. REGULATIONS. [Added by sec. 250, Rev. Act 1942.]

The Secretary of the Treasury is authorized to prescribe, from time to time, such rules and regulations as may be necessary to carry out the preceding provisions of this Part.

SEC. 783. CREDIT FOR DEBT RETIREMENT. [Added by sec. 250, Rev. Act 1942.]

(a) *General rule.* An amount equal to 40 per centum of the amounts paid during the taxable year in repayment of the principal of indebtedness shall, at the election of the taxpayer made in its return for such year, be allowed as a credit against the tax for such year imposed by this subchapter.

(b) *Limitations.* The credit under subsection (a) with respect to any taxable year shall in no event exceed whichever of the following amounts is the lesser—

(1) An amount equal to 10 per centum of the tax imposed under this subchapter for the taxable year.

(2) An amount equal to 40 per centum of the amount by which the smallest amount of indebtedness during the period beginning September 1, 1942, and ending with the close of the preceding taxable year exceeds the amount of indebtedness as of the close of the taxable year.

(3) In case such taxable year begins in 1942 prior to September 2, 1942, and ends after September 1, 1942, an amount equal to 40 per centum of the amount by which the amount of indebtedness as of September 1, 1942, exceeds the amount of indebtedness as of the close of the taxable year.

(4) In case such taxable year begins in 1941 or ends before September 1, 1942, zero.

No interest shall be allowed or paid by the United States on account of any overpayment of tax attributable to any credit allowed under this section.

(c) *Reduction of credit and of bonds outstanding under section 780.* If a credit is allowed for debt repayment in a taxable year pursuant to this section, the amount of such credit or refund shall be deducted from the credit under section 780 (a) and the amount of bonds issued under section 780 shall, to the extent necessary, be correspondingly adjusted.

(d) *Definition of indebtedness.* For the purposes of this section the term "indebtedness" means any indebtedness of the taxpayer or for which the taxpayer is liable evidenced by a bond, note, debenture, bill of exchange, certificate, or other evidence of indebtedness, mortgage, or deed of trust.

§ 35.783–1 *Credit for debt retirement*—(a) *General rule.* Subject to the limitations prescribed in section 783 (b), a taxpayer may, at its election, credit against the excess profits tax for the taxable year an amount equal to 40 percent of the aggregate of the amounts paid by the taxpayer during such year in repayment of the principal of indebtedness (as defined in section 783 (d)). The credit is allowable with respect to amounts so paid, whether they constitute part or full payment of the principal of indebtedness.

The credit is allowable only with respect to "amounts paid" by the taxpayer. If, for example, indebtedness of the taxpayer in the amount of $1,000 is satisfied by a payment of $900 by the taxpayer, the credit is allowable only with respect to the $900 paid. Moreover, mere reduction in indebtedness is not enough. Thus, where a taxpayer pays off its obligation on a bond for $1,000 with its

bond for $900 (having a later maturity or a higher interest rate) no credit is allowable though there has been a reduction of $100 in indebtedness.

The credit is allowable only with respect to amounts paid "in repayment of the principal of indebtedness." Thus, if the taxpayer purchases its own bonds as an investment or for resale as distinguished from the payment of its bonds, the credit is not allowable. If there has been a payment, as distinguished from a purchase, the fact that the evidence of an indebtedness such as a bond has not been retired and canceled in the same taxable year in which acquired by the debtor taxpayer does not preclude allowance of the credit against the tax for such year. Whether in any case an amount paid by the taxpayer upon the principal of indebtedness was paid "in repayment of the principal of indebtedness" is dependent upon all the facts and circumstances.

If the taxpayer desires to take the credit for a taxable year in which amounts are paid in repayment of indebtedness, the election to take the credit must be made in the taxpayer's return for such year. An election not to take the credit for that year, once made by filing a return on which the credit is not taken, is irrevocable after the expiration of the time prescribed by law for filing the return for such year (including the period of any extension of time for filing the return granted pursuant to section 53). An election to take the credit, once made by filing a return on which the credit is taken, similarly become irrevocable. The election to take the credit, or not to take the credit, for any taxable year does not in any case constitute an election for any subsequent year.

(b) *Limitations.* The limitations provided in section 783 (b) upon the credit for debt retirement are as follows:

(1) No credit for debt retirement is allowable against excess profits tax for any taxable year which ended before September 1, 1942. This is true though a post-war credit is allowable in the case of certain of such years. (See § 35.780–1 (a).)

(2) In the case of a taxable year which began in 1942 prior to September 2, 1942, and ends after September 1, 1942, the credit shall in no event exceed whichever of the following amounts is the lesser:

(i) An amount equal to 10 percent of the excess profits tax imposed upon the taxpayer for such year; or

(ii) An amount equal to 40 percent of the amount by which the amount of indebtedness as of the beginning of September 1, 1942, exceeds the amount of indebtedness as of the close of the taxable year.

(3) In the case of any taxable year beginning after September 1, 1942, the credit shall in no event exceed whichever of the following amounts is the lesser:

(i) An amount equal to 10 percent of the excess profits tax imposed upon the taxpayer for such year; or

(ii) An amount equal to 40 percent of the amount by which the smallest amount of indebtedness during the period beginning with the first moment of September 1, 1942, and ending with the close of the preceding taxable year exceeds the amount of indebtedness as of the close of the taxable year.

The tax imposed, for purposes of the limitations described in this paragraph, is the amount determined as the tax imposed for purposes of section 780 (a) (see § 35.780–1 (a)), as such amount may (by reason of refunds, credits, or deficiencies) be adjusted pursuant to section 781 (a) and (b) (see § 35.781–1 (a)). The limitations prescribed in section 781 (d) upon the post-war credit are not limitations upon the credit for debt retirement.

In the following examples of the computation of the credit allowable for debt retirement all indebtedness referred to is indebtedness as defined in section 783 (d) (see § 35.783–1 (d)).

Example (1). The excess profits tax imposed upon the X Corporation for the calendar year 1942 is $200,000. The amounts paid by the corporation throughout the year in repayment of indebtedness total $85,000. The outstanding indebtedness of the corporation during the year is as follows:

	Paid	Borrowed	Total indebtedness
January 1, 1942			$100,000
April 3	$25,000		75,000
July 10		$200,000	275,000
September 1			275,000
October 22	60,000		215,000
December 31			215,000
Total paid	85,000		

The credit allowable for debt retirement is $20,000, computed as follows:

40 percent of $85,000, the total repaid in the year (see section 783 (a) and § 35.783–1 (a))	$34,000

But the credit for debt retirement may not exceed whichever of the following amounts is the lesser (see section 783 (b) (1) and (3) and § 35.783–1 (b) (2)):

10 percent of $200,000 (amount of tax imposed)	$20,000
40 percent of $60,000 (amount by which indebtedness September 1, 1942, $275,000, exceeds indebtedness at close of taxable year 1942, $215,000)	24,000

Example (2). The excess profits tax imposed upon the Y Corporation for the calendar year 1942 is $700,000, and for the calendar year 1943 is $800,000. The amounts paid by the corporation in repayment of indebtedness throughout the year 1942 total $150,000, and throughout the year 1943 total $170,000. The outstanding indebtedness of the corporation during the years 1942 and 1943 is as follows:

	Paid	Borrowed	Total indebtedness
January 1, 1942			$500,000
July 10	$100,000		400,000
September 1			400,000
October 22	50,000		350,000
December 3		$20,000	370,000
December 31			370,000
Total paid	150,000		
January 1, 1943			370,000
November 5	170,000		200,000
December 31			200,000
Total paid	170,000		

The credit allowable for debt retirement for 1942 is $12,000, computed as follows:

40 percent of $150,000, the total repaid in 1942 (see section 783 (a) and § 35.783–1 (a))	$60,000

But the credit for debt retirement for 1942 may not exceed whichever of the following amounts is the lesser (see section 783 (b) (1) and (3) and § 35.783–1 (b) (2)):

10 percent of $700,000 (amount of tax imposed)	$70,000
40 percent of $30,000 (amount by which indebtedness September 1, 1942, $400,000, exceeds indebtedness at close of taxable year 1942, $370,000)	12,000

The credit allowable for debt retirement for 1943 is $60,000, computed as follows:

40 percent of $170,000, the total repaid in 1943 (see section 783 (a) and § 35.788–1 (a))	$68,000

But the credit for debt retirement for 1943 may not exceed whichever of the following amounts is the lesser (see section 783 (b) (1) and (2) and § 35.783–1 (b) (3)):

10 percent of $800,000 (amount of tax imposed)	$80,000
40 percent of $150,000 (amount by which lowest amount of indebtedness during period beginning September 1, 1942, through close of preceding taxable year (December 31, 1942), $350,000, exceeds indebtedness at close of taxable year (December 31, 1943), $200,000)	60,000

Example (3). The facts are the same as in example (2), except that, instead of paying $50,000 on October 22, 1942, and borrowing $20,000 on December 3, 1942, the Y Corporation borrows $20,000 on October 22, 1942, and pays $50,000 on December 3, 1942.

The credit allowable for debt retirement for 1942 is $12,000, the same amount as arrived at in example (2) and computed in the same manner as in such example.

The credit allowable for debt retirement for 1943 is $68,000 (as distinguished from $60,000 under example (2)), computed as follows:

40 percent of $170,000, the total repaid in 1943 (see section 783 (a) and section 35.783–1 (a))	$68,000

Since the lowest amount of indebtedness in the period September 1, 1942, to the close of preceding taxable year is $370,000, as distinguished from $350,000 in example (2), the amount of the limitation under section 783 (b) (2) is a higher amount than the corresponding amount under example (2). The limitations under section 783 (b) (1) and (2) (see § 35.783–1 (b) (3)), are as follows:

10 percent of $800,000 (amount of tax imposed)	$80,000
40 percent of $170,000 (amount by which lowest amount of indebtedness during period beginning September 1, 1942, through close of preceding taxable year (December 31, 1942), $370,000, exceeds indebtedness at close of taxable year (December 31, 1943), $200,000)	68,000

Example (4). The excess profits tax imposed upon the Z Corporation for the calendar year 1942 is $30,000, and for the calendar year 1943 is $15,000. On January 1, 1942, the Z Corporation was the owner of certain real property subject to a mortgage executed by the corporation. The mortgage secured a promissory note made by the corporation, payable to mortgagee M in the amount of $100,000. On October 1, 1942, the Z Corporation conveyed the property, subject to the

mortgage, to the R Corporation, and the latter assumed the indebtedness. The Z Corporation, however, remained liable for the indebtedness. On November 2, 1942, the R Corporation paid $15,000 on the note, the only amount paid by the R Corporation on the indebtedness. M foreclosed the mortgage in 1943, the net proceeds from the foreclosure sale of the property amounting to $80,000, which was paid and credited upon the indebtedness on November 15, 1943, leaving $5,000 still owing upon the original indebtedness. The Z Corporation, on December 15, 1943, paid the $5,000 to M upon the latter's demand therefor. During the years 1942 and 1943 the Z Corporation had no other indebtedness outstanding, nor was any other indebtedness incurred or paid by it. The outstanding indebtedness of the Z Corporation during the years 1942 and 1943 is as follows:

	Paid by Z Corporation	Paid by R Corporation or from proceeds of foreclosure sale	Total indebtedness
January 1, 1942			$100,000
September 1			100,000
November 2		$15,000	85,000
December 31			85,000
	(1)		
January 1, 1943			85,000
November 15		80,000	5,000
December 15	5,000		
December 31			
Total paid	5,000		

[1] Nothing paid.

No credit for debt retirement is allowable to the Z Corporation for the year 1942, since it paid no amounts in repayment of indebtedness.

The credit allowable for debt retirement for 1943 is $1,500, computed as follows:

40 percent of $5,000, the total repaid by Z Corporation in 1943 (see section 783 (a) and § 35.783–1 (a)) $2,000

But the credit for debt retirement for 1943 may not exceed whichever of the following amount is the lesser (see section 783 (b) (1) and (2) and § 35.783–1 (b) (3)):

10 percent of $15,000 (amount of tax imposed) $1,500

40 percent of $85,000 (amount by which lowest amount of indebtedness during period beginning September 1, 1942, through close of preceding taxable year (December 31, 1942) $85,000, exceeds indebtedness at close of taxable year (December 31, 1943), zero) 34,000

(c) *Effect upon post-war credit and bonds.* The post-war credit and bonds purchased with such credit are required by section 783 (c) to be reduced by the amount allowed as a credit for debt retirement. If in any case the amount of the credit for debt retirement for a taxable year exceeds the post-war credit allowable for such year, the post-war credit or bonds issued to the taxpayer for any other taxable year or years shall be reduced by the amount of such excess. The Commissioner of Internal Revenue shall certify to the Secretary a statement of the amount, if any, by which the amount of bonds outstanding should be reduced.

(d) *Definition of indebtedness.* For the purposes of the credit for debt retirement, the term "indebtedness" means any indebtedness of the taxpayer or for which the taxpayer is liable which is evidenced by a bond, promissory note, debenture, bill of exchange, certificate, or other evidence of indebtedness, mortgage, or deed of trust, executed by either the taxpayer or any other person. Indebtedness as used in the preceding sentence means an unconditional and legally enforceable obligation for the payment of money. It includes outstanding obligations of the taxpayer held by the taxpayer for investment or resale. It does not include a contingent obligation. However, if and when a contingent obligation for the payment of money becomes absolute it is included in indebtedness. The term "indebtedness" includes indebtedness assumed by the taxpayer even though such indebtedness is evidenced, so far as the taxpayer is concerned, only by a contract with the person whose indebtedness has been assumed. An assumption of indebtedness includes, in addition to the customary forms of assumption, the acquisition of property subject to indebtedness. If indebtedness of the taxpayer or for which the taxpayer is liable is assumed by another person (thus becoming indebtedness of such other person), it does not thereby cease to be indebtedness of the taxpayer or for which the taxpayer is liable. (But credit for debt retirement is allowable to a taxpayer only with respect to amounts paid by the taxpayer. See section 783 (a) and § 35.783–1 (a).) An obligation ceases to be indebtedness when it is satisfied (such as by payment, whether by the taxpayer or another person), extinguished, or otherwise ceases to be legally enforceable, though such indebtedness may be replaced by indebtedness to another person or new indebtedness to the same person.

The term "indebtedness" does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check.

In order for any indebtedness to be included within the term it must be bona fide. It must be incurred for business reasons and not merely to increase the excess profits credit or the credit for debt retirement.

Whether outstanding certificates designated by such names as "debenture preferred stock" or "guaranteed preferred stock" constitute indebtedness depends upon whether the holder has a proprietary interest in the corporation or has the rights of a creditor, determined in the light of all the facts. The name borne by the certificate is of little importance. More important attributes to be considered are whether or not there is a maturity date, the source of payment of any "interest" or "dividend" specified in the certificate (whether out of earnings or out of capital and earnings), rights to enforce payment, and other rights as compared with those of general creditors.

The term "other evidence of indebtedness" refers to evidence of indebtedness of the same general character as bonds, notes, debentures, bills of exchange, or certificates of indebtedness. Open account book entries, invoices, or statements of account are not evidences of indebtedness.

In pursuance of the Internal Revenue Code the foregoing regulations are hereby prescribed, applicable only to taxable years beginning after December 31, 1941, and Part 30 and Treasury decisions in amendment thereof, in so far as Part 30 and such Treasury decisions relate to excess profits taxes for taxable years beginning after December 31, 1941, are hereby superseded, except that where it is appropriate under Part 30 and such Treasury decisions to apply with respect to taxable years beginning after December 31, 1939, and before January 1, 1942, the rules applicable to taxable years beginning after December 31, 1941, these regulations shall be applicable.

[SEAL] ROBERT E. HANNEGAN,
Commissioner of Internal Revenue.

Approved: January 25, 1944.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

[F. R. Doc. 44–1372; Filed, January 26, 1944; 4:45 p. m.]

TITLE 32—NATIONAL DEFENSE

Chapter IX—War Production Board

Subchapter B—Executive Vice-Chairman

AUTHORITY: Regulations in this subchapter issued under sec. 2 (a), 54 Stat. 676, as amended by 55 Stat. 236 and 56 Stat. 176; E.O. 9024, 7 F.R. 329; E.O. 9125, 7 F.R. 2719; W.P.B. Reg. 1 as amended March 24, 1943, 8 F.R. 3666, 3696; Pri. Reg. 1 as amended May 15, 1943, 8 F.R. 6727.

PART 962—IRON AND STEEL

[Supplementary Order M–21–a, Revocation of Direction 1]

REJECTED CORROSION AND HEAT RESISTANT ALLOY STEEL

Direction 1 to Supplementary Order M–21–a is hereby revoked. This revocation does not affect any liabilities incurred under the Direction. Deliveries of rejected corrosion and heat resistant alloy steel remain subject to all other applicable regulations and orders of the War Production Board.

Issued this 1st day of February 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 44–1592; Filed, February 1, 1944; 11:31 a. m.]

PART 3175—REGULATIONS APPLICABLE TO THE CONTROLLED MATERIALS PLAN

[CMP Reg. 1, Direction 16, as Amended Feb. 1, 1944]

REPLACEMENT OF DEFECTIVE CONTROLLED MATERIAL

The following direction is issued pursuant to CMP Regulation No. 1 (§ 3175.1)

to all controlled materials producers providing for the replacement of material rejected by a customer because of nonconformity with specifications.

STEEL

(1) When steel is rejected by a customer for non-conformity with specifications, or other defect, the producer must schedule and make replacement in preference to all other orders for similar material, without requiring an additional allotment, in the absence of specific written instructions by the War Production Board or the customer to the contrary. If, after the producer has shipped the replacement order, it develops that the rejection was improper, the customer must either return the material, or furnish the necessary certification to support the replacing shipment, charging the appropriate allotment. The provisions of paragraphs (t) (4) and (t) (5) of CMP Regulation No. 1 shall not restrict delivery of replacement orders.

(2) If any portion of the rejected steel can be used by the customer in connection with an authorized production schedule, it may be so used, but the customer must charge the material used to the appropriate allotment. However, defective steel received by a customer prior to July 1, 1943, may be used on any duly authorized order without any charge to an allotment.

(3) If any portion of the rejected steel can be used by the producer for delivery on another authorized controlled material order or for a delivery otherwise permitted by applicable War Production Board Regulations or orders, it may be so used.

(4) Deleted Feb. 1, 1944. (The deletion of this paragraph means that beginning February 1, 1944 the rules stated above apply equally to replacement orders for stainless steel.)

COPPER

(1) Copper produced to fill authorized Controlled Material orders and rejected by a customer for nonconformity with specifications shall be replaced in preference to all other orders in the absence of specific instructions by the Copper Division of the War Production Board to the contrary. The provisions of subparagraphs (4) and (5) of paragraph (t) of CMP Regulation No. 1 shall not restrict delivery of replacement orders. If the replacement copper is not delivered before 30 days following the expiration of the quarter in which delivery was originally scheduled, the producer must report the matter to the Copper Division before making delivery. However, no further authorization is required.

(2) Such replacements shall be made without requiring the extension of an additional allotment, even though delivery of the material is made in a subsequent quarter. If, however, some of the material cannot be replaced in time to meet a War Production Board production schedule or the delivery requirements of the producer's customer, the producer shall immediately notify the Copper Division in writing, giving a full explanation. The customer may receive the replacement copper without making further charge to an allotment, even if the copper is delivered in a subsequent quarter.

(3) The customer rejecting material shall immediately report the facts to the producer and dispose of such material only in accordance with written instructions from the producer. Unless the material is scrap, the producer, despite the provisions of § 944.11 of Priorities Regulation No. 1, shall direct that the material be returned to him or be delivered to another customer to fill any order which the producer is entitled to fill with new material under applicable regulations and directions. If the material is scrap it must be handled pursuant to Order M-9-b.

ALUMINUM

(1) Replacement orders for rejected aluminum shall be filled in preference to all other orders not in actual production on the day of the receipt of the replacement order. The provisions of subparagraphs (4) and (5) of paragraph (t) of CMP Regulation No. 1 shall not restrict delivery of replacement orders.

(2) Replacement orders for rejected aluminum are deemed to be covered by the same authorized controlled material order or other authorized order against which the rejected shipment was made. Accordingly, the producer shall not require an additional allotment or other authorization from his customer to secure replacement material if the original shipment was made in accordance with applicable regulations and directives even though delivery of the material is made in a subsequent quarter. The customer may receive the replacement aluminum without making further charge to an allotment, even if delivered in a subsequent quarter.

(3) The rejection of the material shall be reported immediately to the producer and despite provisions of § 944.11 of Priorities Regulation No. 1, the material shipped by his customer in accordance with his instructions. Unless the material is scrap, he shall direct that the material be returned to him or delivered to another customer to fill any order which he is entitled to fill with new material under applicable regulations and directives. If the material is scrap, it must be handled pursuant to order M-1-d.

Issued this 1st day of February 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 44-1588; Filed, February 1, 1944; 11:32 a. m.]

PART 3208—SCHEDULED PRODUCTS

[General Scheduling Order M-293, Direction 1 to Table 14]

PRODUCTION OF BOILERS FOR STOCK

In order to conserve materials and manufacturing facilities for the production of high and low pressure steel boilers listed on Table 14 of General Scheduling Order M-293, and to prevent the accumulation of duplicate stocks of such high and low pressure steel boilers in the hands of manufacturers, dealers and warehouses, the following direction under Table 14 of M-293 is issued:

(1) Notwithstanding the provisions of Priorities Regulation 1, or of paragraphs (c) (2) and (d) (2) of General Scheduling Order M-293, no manufacturer shall, without specific authorization from the War Production Board, begin production of any high and low pressure steel boilers listed on Table 14 of General Scheduling Order M-293, which the manufacturer knows or has reason to believe, will be held in the stock of any manufacturer, wholesaler, dealer or any other person rather than shipped directly for installation.

(2) Application for such specific authorization should be made by letter addressed to War Production Board, Washington 25, D. C., Reference M-293, Table 14.

Issued this 1st day of February 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 44-1591; Filed, February 1, 1944; 11:32 a. m.]

PART 3281—PULP AND PAPER

[General Limitation Order L-120, Interpretation 1 to Schedule VII]

COMMERCIAL ENVELOPES

The following interpretation is issued with respect to Schedule VII of General Limitation Order L-120:

Under paragraph (b) (1) (ii) of Schedule VII, an exception from the substance weight restrictions is made for filing and document envelopes. This means that it is permissible to use papers heavier than substance 28 in the manufacture of filing and document envelopes when such envelopes are designed and sold particularly for use in connection with the permanent filing of documents, securities, records, etc., in filing cabinets, vaults, safe depositories and similar devices where safety and permanence are of paramount importance or for use in filing cabinets where rigidity of the filing material is necessary for the proper functioning of the filing system. Such items as bank pass book, license holders, photo negatives and similar envelopes not used in filing cabinets are not permitted to be made from papers heavier than 28 substance.

Users of filing and packaging envelopes can be of assistance to the manufacturer, in those instances where heavier weights may be permitted, by including in their order a statement as to the end use of the envelope.

Issued this 1st day of February 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 44-1589; Filed, February 1, 1944; 11:32 a. m.]

PART 3292—AUTOMOTIVE VEHICLES, PARTS AND EQUIPMENT [1]

[Conservation Order M-311, as Amended Feb. 1, 1944]

USED AUTOMOTIVE PARTS

The fulfillment of requirements for the defense of the United States having created a shortage in the supply of automotive parts for defense, for private account and for export, the following order is deemed necessary and appropriate in the public interest and to promote the national defense.

§ 3292.81 [1] *Conservation Order M-311*—(a) *Purpose of this order.* The purpose of this order is to assure that in the dismantling of used motor vehicles, serviceable parts are not scrapped, but are made available to meet the nation's transportation needs. This order does not prohibit the dismantling of used automobiles. On the contrary, all trucks and vehicles in auto wreckers' inventories should be dismantled as rapidly as possible, so that the serviceable parts from them will be readily available as needed, and so that the balance of the vehicle can be moved promptly into scrap channels.

(b) *Applicability of regulations.* This order and all transactions affected thereby are subject to all applicable provisions of the regulations of the War Production Board, as amended from time to time.

[1] Formerly Part 3239, § 3239.1.

(c) *Definitions.* For the purposes of this order:

(1) "Person" means any individual, partnership, association, business trust, corporation or other organized group of persons, whether incorporated or not, who in the course of trade, buys, sells, receives, or processes used automotive parts for re-sale either "as is", rebuilt or reconditioned, and automotive wreckers, used automotive parts dealers and scrap dealers, and also any Federal Department, Bureau or Agency, and State or political subdivision thereof. This definition does not include steel mills, foundries or furnaces.

(2) "Motor vehicle" means any passenger automobile, light, medium, or heavy motor truck or passenger carrier, powered with an internal combustion engine; or full trailer, semi-trailer or third axle attachment.

(3) "Used automotive part" means any part listed in Schedule A to this order which has been used in a motor vehicle.

(4) "No longer serviceable" means, when applied to a used automotive part, that it is so worn, broken or damaged that use in its present condition or restoration by rebuilding or reconditioning is impracticable.

(5) "To scrap, to sell as scrap or deliver as scrap" when applied to a used automotive part listed in Schedule A to this order, means to melt, sell or deliver for melting; or to damage, destroy or render useless any such part for the purpose of selling the same as scrap metal.

(6) "Consumer" means the owner or operator of the motor vehicle for which a used automotive part is required.

(d) *Prohibition on scrapping used automotive parts.* On and after June 1, 1943, irrespective of the terms of any contract, agreement or other commitment, no person, as defined in paragraph (b) (1) above, shall scrap, sell as scrap or deliver as scrap any used automotive part listed in Schedule A except when such part is "no longer serviceable". This prohibition shall not apply:

(1) To the sale or delivery of vehicles or chassis to auto wreckers and scrap dealers; to the sale or delivery of vehicles or chassis to or by automotive dealers, repair shops and garages, or between individuals; or to the sale or delivery of used automotive parts other than as scrap.

(2) To the sale or delivery of used parts purchased as scrap by scrap dealers.

(e) *Restrictions on sales to consumers*—(1) *Purchaser to turn in old part.* No person shall sell or deliver any used automotive part to a consumer unless the consumer delivers to such person a used automotive part of similar type and size for each used part delivered to the consumer. However, a used automotive part need not be turned in in the following cases: (i) if the used part has been consumed in use, lost or stolen; (ii) if the used part is ordered by telephone, telegram or mail and shipped to the purchaser.

(2) The foregoing restrictions on the sale of used automotive parts shall not apply to any Federal Department, Bureau or Agency, or to any State or political subdivision thereof, which is restricted by law from making such disposal of used automotive parts.

(f) *Authorization to scrap automotive parts or vehicles.* Application for authority to scrap, sell as scrap or deliver as scrap any used automotive parts of the types listed in Schedule A which are still serviceable, or vehicles, may be made by filing a letter in duplicate with the Field Office of the War Production Board for the District in which is located the applicant's place of business, marked ref: Order M-311. If the application is for authority to scrap individual parts already removed, the parts should be listed showing (1) the quantity of each on hand, (2) the quantity of each to be scrapped, and (3) the make, model and year of the vehicle from which each was obtained, or otherwise identified. If the application is for authority to scrap a vehicle or vehicles or the chassis thereof, without removal of parts for inspection as to serviceability, the applicant should list each vehicle or chassis, identifying it by make, model and year. The reporting provisions of this paragraph have been approved by the Bureau of Budget in accordance with the Federal Reports Act of 1942.

(g) *Special directions.* Whenever it is determined by the War Production Board that motor vehicles acquired by any auto wrecker are not being dismantled at a rate sufficient to meet the needs for scrap and serviceable parts, the Board by written direction may order such auto wrecker not to purchase or accept delivery of additional motor vehicles or parts thereof until he shall have dismantled the number of motor vehicles then in his inventory which may be specified in such direction.

(h) *Violations.* Any person who wilfully violates any provision of this order or who, in connection with this order, wilfully conceals a material fact or furnishes false information, to any department or agency of the United States, is guilty of a crime, and upon conviction may be punished by fine or imprisonment. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using materials under priority control and may be deprived of priorities assistance by the War Production Board.

(i) *Application of this order.* The terms and restrictions of this order shall not apply outside the continental United States.

(j) *Communications.* All communications concerning this order shall, unless otherwise directed, be addressed to War Production Board, Automotive Division, Washington 25, D. C., Reference: M-311.

Issued this 1st day of February 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

SCHEDULE A

The used automotive parts to which this order applies are listed below, and include such parts for all motor vehicles regardless of make, model, or year. This schedule will be amended from time to time by the addition or removal of certain parts, or by specifying parts for certain make, year or model of vehicles, or otherwise.

Axles

Axle shaft
Front axle assembly
Propeller shaft
Ring and pinion gear
Shock absorber
Universal joint
Front wheel suspension

Bearings

Ball
Roller
Taper

Springs

Coil spring
Spring front, including coil springs
Spring rear

Starting and Generator Equipment

Generator
Generator armature
Starter motor
Starter armature
Starter bendix
Voltage regulator

Brake

Brake drum
Brake Shoe

Clutch

Clutch assembly

Cooling system

Radiator
Radiator core
Water Pump

Engine

Engine assembly
Engine block
Cylinder head
Cylinder sleeve (wet)
Connecting rod

Fuel system

Fuel pump
Carburetor

Ignition system

Coil
Distributor
Spark plug

Steering

Steering assembly

Transmission

Transmission assembly
Transmission gears

Special truck equipment

Air brake
Auxiliary transmission
Booster brake
Dead axle
Two-speed axle assembly
Fifth wheel and mounting
Hydraulic hoist
Pole setter
Power take-off
Power winch
Refrigerator unit
Reserve gasoline tank
Vacuum tank
Helper springs

[F. R. Doc. 44-1590; Filed, February 1, 1944; 11:32 a. m.]

Chapter XI—Office of Price Administration

PART 1305—ADMINISTRATION

[Gen. RO 2[1], Amdt. 1]

INSTITUTIONAL USERS

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

General Ration Order No. 2 is amended in the following respect:

Section 1305.201 (c) is amended to read as follows:

(c) The person required to keep the records shall retain them until December 31, 1944.

This amendment shall become effective January 31, 1944.

(Pub. Law 671, 76th Cong.; as amended by Pub. Laws 89, 421, and 507, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9280, 7 F.R. 10179; W.P.B. Dir. 1, Supp. Dir. 1-E, 1-M and 1-R, 7 F.R. 562, 2965, 7234, 9684, respectively; Food Dir. 3, 5, 6 and 7, 8 F.R. 2005, 2251, 3471, respectively)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1559; Filed, January 31, 1944; 11:48 a. m.]

*Copies may be obtained from the Office of Price Administration.

[1] 7 F.R. 10070.

PART 1312—LUMBER AND LUMBER PRODUCTS

[MPR 348,[1] Amdt. 33]

LOGS AND BOLTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation 348 is amended in the following respect:

Appendix D, Table 1, Maximum Prices for 100" Box Bolts is amended by the addition of the following paragraph at the conclusion of the price table:

Dealer's commission. If a consumer purchases Box Bolts through a dealer, such consumer may pay such dealer, in addition to the ceiling price, a commission of not to exceed 50 cents per cord of 133 cubic feet.

In no event shall a person receive a dealer's commission, or the proceeds of any such commission on Box Bolts cut by him on his own operations. In no event shall a person receive a dealer's commission on the cut of another person pursuant to any contract agreement or understanding of any sort whatsoever between the two whereby each is to sell and charge a commission on the wood cut by the other. In no event shall the dealer's commission be split or divided with any person. In addition to the price paid by the consumer a dealer may receive a dealer's commission only from a consumer and only if the dealer fulfills all the following requirements (i) through (vii) inclusive with respect to the transactions:

(i) Copies must be kept of all contracts or settlement sheets in which a dealer's commission is charged.

(ii) The deliveries must be made by the dealer to the consumer.

(iii) The Box Bolts sold by the dealer to the consumer must have been completely prepared for delivery by a person other than the dealer.

(iv) The dealer must guarantee the merchantable quality of the Box Bolts and that they are free from all liens and incumbrances:

(v) The dealer's commission in such transactions must be shown as a separate item on the settlement sheet. This settlement sheet must contain a statement that the dealer has had no part in the preparation of the Box Bolts, and that the charges are not in excess of Maximum Price Regulation No. 348.

(vi) The dealer's allowance must not be split or divided with any other person.

(vii) All pertinent provisions in this Maximum Price Regulation No. 348 must be strictly complied with.

"Dealer" means any person who sells to consumers, Box Bolts not cut or prepared by such person, but purchased by such person in the condition in which it is to be delivered to the consumer.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1554; Filed, January 31, 1944; 11:52 a. m.]

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 16115, 16198, 16204, 16297.

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[RO 1A,[1] Amdt. 67]

TIRES, TUBES, RECAPPING AND CAMELBACK

A rationale for this amendment has been issued simultaneously herewith and has been filed with the Division of the Federal Register.*

Ration Order No. 1A is amended in the following respects:

1. Section 1315.401 (c) is amended by adding the following sentence as the first sentence of the paragraph: The Board may delay action on an application filed by an eligible person until it is satisfied that its approval of such application will not deprive more essential applicants of certificates by reason of inadequate quotas.

2. Section 1315.501 (e) is amended to read as follows:

(e) *No available tires or tubes.* That the applicant, other than a Federal, State, Local or Foreign Government or Government Agency, does not own or control a tire or tube, other than tires or tubes mounted upon vehicles or equipment in current use (including one spare for each size wheel per vehicle or piece of equipment) which can be used, or repaired for use in lieu of the tires or tubes sought to be replaced; *Provided, however,* That an applicant who is required to operate at high speeds in emergencies may, in addition, be allowed two mud and snow tires. In computing the number of tires or tubes owned or controlled, the applicant shall not include (1) emergency reserves acquired in accordance with § 1315.507; (2) tires or tubes reported on OPA Form R-17 or reported by a manufacturer to the War Production Board; or (3) tires or tubes in a public warehouse which are removable only upon certificate.

3. Section 1315.502 (c) is amended to read as follows:

(c) *Spare tire.* That he does not own or control a serviceable tire for use on each running wheel on the vehicle for which application is made, plus a tire which is not serviceable for continued use on a running wheel, but can still be used or repaired for use as a spare tire in emergencies. An applicant who is required to operate at high speeds in emergencies may establish his need for a tire under this paragraph if his spare tire is not serviceable for continued use on a running wheel.

4. Section 1315.503 is amended to read as follows:

§ 1315.503 *Eligibility of passenger automobile.* A consumer who meets the applicable conditions of § 1315.501 and § 1315.502 may be granted a certificate for tires and new tubes for a passenger automobile in accordance with the following:

(a) *Reconsideration of gasoline ration.* The Board shall first reconsider the gasoline ration issued for use with the passenger automobile, pursuant to § 1394.-8110 of Ration Order No. 5C. The consumer's eligibility for a tire or new tube shall be based on the purposes for which his vehicle is used as determined by the Board after such reconsideration.

(b) *Eligibility for Grade I tires*—(1) *Preferred mileage purposes.* A certificate for a Grade I tire (or a Grade III tire, at the applicant's option) may be issued:

(i) For a passenger automobile which is used for one or more of the purposes described in § 1394.7706 (preferred mileage) of Ration Order No. 5C, if its total rationed mileage (excluding mileage allowed on special rations) is 121 miles or more per month or it is operated on a non-highway ration or is not propelled by gasoline;

(ii) To an applicant who operates fleet or official passenger automobiles on interchangeable gasoline ration books, if he establishes that the vehicle for which application is being made will be operated for one of the purposes described in § 1394.7706 of Ration Order No. 5C.

(2) *Obsolete size and motorcycle tires.* A certificate for a Grade I tire of an obsolete size or a new motorcycle tire may be issued to replace an obsolete size tire or a motorcycle tire which cannot be recapped either because of its physical condition or the lack of recapping facilities, but only if:

(i) A valid supplemental gasoline ration is outstanding for the vehicle for which the tire is sought; or

(ii) In any area in which the basic ration is deemed to include occupational mileage, if the vehicle is operated with a basic ration only and if any of the purposes for which the vehicle is used constitute occupational mileage as defined in § 1394.7551 (a) (27) of Ration Order No. 5C, and if the applicant has established the facts required by § 1394.7704 (a) of Ration Order No. 5C for the allowance of such occupational mileage;

(iii) The vehicle is operated on a non-highway ration only or is not propelled by gasoline, and if any of the purposes for which the vehicle is used constitute occupational mileage as defined in § 1394.7551 (a) (27) of Ration Order No. 5C and if the applicant has established the facts required by § 1394.7704 (a) of Ration Order No. 5C for the allowance of such occupational mileage.

The term "obsolete size tire" means passenger-type tires of the following sizes only:

4.00–15	3.85–18
5.00–15	4.00–18
4.50–17	4.40–18
4.75–17	4.50–18
5.00–17	4.75–18
6.50–17	5.00–18
6.00/6.50–17	6.00–18
7.00–17	6.50–18
7.50–17	6.00/6.50–18
3.30–18	7.00–18
3.50–18	7.50–18
3.75–18	7.00/7.50–18

[1] 7 F.R. 9160, 9392, 9724, 10079, 10085, 10264, 10430, 10733, 11480, 11481, 11952, 11846, 12013, 13247, 13293, 13247, 13293, 13172, 13845, 13706, 13846, 13395, 14049, 14737, 15523, 16245, 16246, 16695, 16894, 17326; 9 F.R. 89.

4.00–19	4.40/4.50/4.75–21
4.40–19	5.00–21
4.50–19	5.25–21
5.25–19	5.00/5.25–21
5.50–19	5.50–21
5.25/5.50–19	6.00–21
6.00–19	6.50–21
6.50–19	7.00–21
6.00/6.50–19	5.00–22
7.00–19	6.00–22
7.50–19	4.40–23
7.00/7.50–19	6.00–23
3.30–20	7.50–24
3.85–20	28 x 3
4.40–20	30 x 3
4.50–20	30 x 3½
4.75–20	32 x 3½
5.00–20	31 x 4
4.50/4.75/5.00–20	32 x 4
5.25–20	33 x 4
5.00/5.25–20	34 x 4
5.50–20	32 x 4½
5.25/5.50–20	33 x 4½
6.00–20	34 x 4½
6.50–20	35 x 4½
6.00/6.50–20	36 x 4½
7.00–20	33 x 5
7.30–20	34 x 5
4.40–21	35 x 5
4.50–21	37 x 5
4.40/4.50–21	35 x 6
4.75–21	

(3) *Limited use of Grade I tires.* An applicant who is otherwise entitled to a Grade I tire may be issued a certificate for a Grade III tire if the length of time for which he will need his allowed monthly mileage will be substantially less than the normal life of a Grade I tire.

(c) *Eligibility for Grade III tires.* A certificate for a Grade III tire may be issued for a passenger automobile which is not eligible under paragraph (b):

(1) If the vehicle is used for an occupational purpose as defined in § 1394.7551 (a) (27) of Ration Order No. 5C and either its total rationed mileage (excluding mileage on special rations) is 121 miles per month or more, or it is operated on a non-highway ration or is not propelled by gasoline and the Board would be entitled to allow mileage for such a purpose to an applicant for a highway ration under § 1394.7704 (a) of Ration Order No. 5C.

(2) If the vehicle is operated on an interchangeable gasoline ration book.

(3) If a basic ration and a special ration issued pursuant to § 1394.7851 (b) (1), (2), or (5) of Ration Order No. 5C are outstanding for the vehicle.

(4) If gasoline is obtained for the vehicle against an Acknowledgment of Delivery (Form OPA R–544 Revised) pursuant to § 1394.7952 of Ration Order 5C. The application must be made within one month of the issuance of the Acknowledgment of Delivery form to the applicant.

(5) If the vehicle is registered and normally garaged or stationed in Canada and gasoline is obtained under a special ration granted pursuant to § 1394.7851 or § 1394.7856 of Ration Order No. 5C. Any Board may issue a certificate for a Grade III tire and a new tube under this subparagraph (5).

(d) *Replacement of recappable tire carcass.* An applicant who cannot prove need for a tire because the tire to be replaced is recappable, but who is otherwise eligible under paragraph (b) or (c), may be issued a certificate for a Grade III tire (or Grade I tire if the applicant is applying under § 1315.503 (b) (2)) in any area where recapping facilities are unavailable or inadequate.

(e) *Eligibility for tubes.* A certificate for a new tube may be issued for any passsenger automobile.

5. Section 1315.507 (c) (2) is amended to read as follows:

(2) Vehicles, other than commercial motor vehicles and equipment, used exclusively for maintaining fire fighting services or in investigation or patrolling necessary to the maintenance of public police services, or eligible under § 1315.506 (a) (2) (off-the-road equipment).

6. Section 1315.516 (b) is amended to read as follows:

(b) *Spare tire.* A Board shall not issue a certificate for a Grade III tire pursuant to this section if the passenger automobile for which application is made is equipped with tires serviceable for use on the running wheels and a tire which, though not serviceable for continued use on a running wheel, can still be used or repaired for use as a spare tire in emergencies.

7. Section 1315.611 (c) (3) is amended by adding to the end of the sentence the phrase "or a 4.00–12 new implement-type tire".

8. Section 1315.705 is amended by deleting the phrase "shall re-examine and re-determine the current gasoline ration issued for such passenger automobile in accordance with § 1315.503 (a) and (b) and".

This amendment shall become effective February 1, 1944.

(Pub. Law 671, 76th Cong. as amended by Pub. Laws 89, 421, and 507, 77th Cong.; E.O. 9125, 7 F.R. 2719, issued April 7, 1942, WPB Dir. No. 1, 7 F.R. 562, Supp. Dir. No. 1Q, 7 F.R. 9121)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1564; Filed, January 31, 1944; 11:50 a. m.]

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[RO 1B,[1] Amdt. 4]

MILEAGE RATIONING: TIRE REGULATIONS FOR PUERTO RICO

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 1B is amended in the following respect:

Section 2.5 (a) (1) is amended by inserting the phrase "or a Grade I" between "truck-type" and "tire".

This amendment shall become effective January 31, 1944.

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 9551, 12695.

(Pub. Law 671, 76th Cong.; as amended by Pub. Law 89, 77th Cong., and Pub. Law 507, 77th Cong., Pub. Law 421 and 729, 77th Cong., E.O. 9125, 7 F.R. 2719, W.P.B. Dir. No. 1, No. 1–J, as amended, 7 F.R. 562, 5043, 8731, Supp. Dir. 1–Q, as amended, 8 F.R. 2013, Rev. Gen. Order No. 20, 8 F.R. 2416)

Issued this 26th day of January 1944.

JORGE L. CORDOVA,
Territorial Director for Puerto Rico.

Approved:

GERALD A. BARRETT,
Acting Regional Administrator, Region IX.

[F. R. Doc. 44–1556; Filed, January 31, 1944; 11:52 a. m.]

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[MPR 403,[1] Amdt. 7]

CERTAIN RUBBER COMMODITIES PURCHASED FOR GOVERNMENTAL USE

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 403 is amended in the following respects:

1. Section 6 (e) is amended to read as follows:

(e) If after June 17, 1943, a manufacturer receives total orders exceeding $1,000 for more than one unit of a commodity for which a maximum price must be determined under this section, he shall file a report. This report shall be filed with the Office of Price Administration, Washington, D. C., within ten days after the manufacturer has received sufficient orders to necessitate the filing of the report. This report shall contain the information required by the form set forth in Appendix B and shall be made on a copy of that form. If the maximum price so reported has not been properly computed, it must be corrected. This correction shall apply retroactively. In any case, the maximum price so reported shall be subject to adjustment (not to apply retroactively) at any time upon the written order of the Office of Price Administration. This adjustment will be made only if the maximum price is not in line with the level of maximum prices established by the regulation.

2. Section 20 (c) (23) is amended to read as follows:

(23) Tarpaulins and covers.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1552; Filed, January 31, 1944; 11:51 a. m.]

[1] 8 F.R. 7498, 8837, 10434, 16406.

PART 1341—CANNED AND PRESERVED FOODS

[MPR 428,[1] Amdt. 3]

CIDER VINEGAR

A statement of the considerations involved in the issuance of this amendment has been issued and filed with the Division of the Federal Register.*

Maximum Price Regulation No. 428 is amended in the following respects:

1. Section 2a is added to read as follows:

SEC. 2a. *Adjustment of maximum prices for 1943 raw material costs.* This section provides an increase in maximum prices of processors and secondary packers of cider vinegar to compensate them for higher 1943 raw material costs. On and after February 5, 1944, the price for an item calculated under this section is the seller's new maximum price, replacing his maximum price previously established under section 2.

(a) *General rule.* Each processor and secondary packer shall adjust his maximum prices under section 2 (a) (1) or 2 (b) (1) for 1943 raw material costs by adding the respective figures listed for each grade and quantity in the following table:

The figures listed in this table are to be added to maximum prices under sections 2 (a) (1) and 2 (b) (1)	60 grain basis	50–59 grain	45–49 grain	40–44 grain
Tank car or tank truck lots, per gallon	$0.08½			
Barrels, per gallon, cooperage included		$0.07	$0.06½	$0.05½
Half-barrels, per gallon, cooperage included		.07	.06½	.05½
Gallons, per dozen		.84	.78	.66
Half-gallons, per dozen		.42	.39	.33
Quarts, per dozen		.21	.19½	.16½
Pints, per dozen		.10½	.09¾	.08¼

For any container size not listed in this table, each processor and secondary packer shall adjust for 1943 raw material costs by adding to his maximum price per gallon for the item under the General Maximum Price Regulation the figure named for barrels of the particular grade of cider vinegar being priced.

(b) *Processors who also perform a wholesale service.* A processor who prior to February 5, 1944 determined a maximum price under section 2 (a) (2) shall refigure the price in accordance with that subparagraph after first adding to the factor referred to in section 2 (a) (2) (i) the appropriate figure named in paragraph (a) of this section.

(c) *Processors who also perform the retail service.* A processor who prior to February 5, 1944 determined a maximum price under section 2 (a) (3) shall refigure the price in accordance with that subparagraph after first adding to the factor referred to in section 2 (a) (3) (i) the appropriate figure named in paragraph (a) of this section.

(d) *Secondary packers who also perform a wholesale service.* A secondary packer who prior to February 5, 1944 determined a maximum price under section 2 (b) (2) shall refigure the price in accordance with that subparagraph after first adding to the factor referred to in section 2 (b) (2) (i) the appropriate figure named in paragraph (a) of this section.

(e) *Secondary packers who also perform the retail service.* A secondary packer who prior to February 5, 1944 determined a maximum price under section 2 (b) (3) shall refigure the price in accordance with that subparagraph after first adding to the factor referred to in section 2 (b) (3) (i) the appropriate figure named in paragraph (a) of this section.

2. Section 8 is amended to read as follows:

SEC. 8. *Notification of change in maximum price.* With the first delivery of an item after the effective date of any amendment to this regulation authorizing a change in maximum price, in any case where the seller's new maximum price is different from the maximum price he previously had for the same item, he shall:

(a) Supply each wholesaler and retailer who purchases from him with written notice as set forth below:

(Insert date)

NOTICE TO WHOLESALERS AND RETAILERS

Our OPA ceiling price for (*describe item by brand, grade and bulk quantity or container type and size*) has been changed by the Office of Price Administration. We are authorized to inform you that if you are a wholesaler or retailer pricing this item under Maximum Price Regulation No. 421, 422 or 423, you must refigure your ceiling price for this item on the first delivery of it to you from your customary type of supplier containing this notification after (*insert effective date of amendment authorizing change in maximum price*). You must refigure your ceiling price following the rules in section 6 of Maximum Price Regulation No. 421, 422 or 423, whichever is applicable to you.

For a period of 60 days after determining the new maximum price for the item, and with the first shipment after the 60-day period to each person who has not made a purchase within that time, each processor and secondary packer shall supply with each bulk quantity and include in each case or carton containing the item, the written notice set forth above, or securely attach it to the outside. However, for sales directly to any retailer, the processor or secondary packer may supply the notice by attaching it to, or stating it on, the invoice covering the shipment, instead of providing it with the goods.

(b) Notify each purchaser of the item from him who is a distributor other than a wholesaler and retailer of the establishment of the new maximum price by written notice attached to, or stated on, the invoice issued in connection with the first transaction with such purchaser after the effective date of the amendment authorizing the change in maximum price, as follows:

(Insert date)

NOTICE TO DISTRIBUTORS OTHER THAN WHOLESALERS AND RETAILERS

Our OPA ceiling price for (*describe item by brand, grade, and bulk quantity or container type and size*) has been changed from $---------- to $---------- under the provisions of Maximum Price Regulation No. 428. You are required to notify all wholesalers and retailers for whom you are the customary type of supplier, purchasing the item from you after (*insert effective date of amendment authorizing change in maximum price*), of any allowable change in your maximum price. This notice must be made in the manner prescribed in section 8 (a) of Maximum Price Regulation No. 428.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1566; Filed, January 31, 1944; 11:51 a. m.]

PART 1346—BUILDING MATERIALS

[RPS 40,[1] Amdt. 3]

BUILDERS' HARDWARE AND INSECT SCREEN CLOTH

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Price Schedule No. 40 is amended in the following respect:

1. A new § 1346.6a is added to read as follows:

§ 1346.6a *Applications for adjustment*—(a) *Padlocks.* On and after February 5, 1944, any manufacturer of padlocks who is unable to maintain his production of padlocks under his existing maximum price or prices will be permitted to adjust his maximum price or prices by an amount not more than that specified under (b) below.

(b) *Extent of relief to be granted.* Whenever it appears that a manufacturer is unable to maintain his production of padlocks at his existing maximum price or prices, the Office of Price Administration may, either on application for adjustment filed in accordance with the provisions of Revised Procedural Regulation No. 1, or on its own motion, by order, adjust his maximum price or prices by an amount necessary to permit the maintenance of such production upon a basis not more than his cost to manufacture and sell the commodity.

The term "cost to manufacture and sell" shall include the cost of material, labor, maintenance, supplies, power, taxes (other than State and Federal in-

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 10358, 12136, 14154.

[1] 7 F.R. 1280, 2132, 8383, 8948; 8 F.R. 7257.

come taxes), insurance, workmen's compensation taxes, royalties, depreciation, other manufacturing expenses, and reasonable costs of selling and administration properly applicable to padlocks. Expenses not related to the manufacturing and selling expenses of padlocks will be excluded.

(c) *Filing of applications.* Applications under this section shall be filed in accordance with Revised Procedural Regulation No. 1.

Before filing an application for adjustment under the provisions of this section, each applicant shall obtain from the Office of Price Administration, Building Materials Price Branch, Washington 25, D. C., a statement of the specific information that will be necessary in order that the application may receive attention.

(d) *Passing on of permitted increase by persons beyond the manufacturer.* In issuing adjustment orders under this section the Price Administrator will, wherever required, provide to what extent any increase permitted under this section, by way of adjustment, may be added to the maximum price or prices of sellers other than the manufacturer. To the extent that any such adjustment is made for retailers, as defined in § 1346.7 (b), this regulation will supersede the General Maximum Price Regulation.

This amendment shall become effective February 5, 1944.

NOTE: The reporting requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1562; Filed, January 31, 1944; 11:49 a. m.]

PART 1347—PAPER, PAPER PRODUCTS, RAW MATERIALS FOR PAPER AND PAPER PRODUCTS, PRINTING AND PUBLISHING

[RMPR 187,[1] Amdt. 3]

CERTAIN PAPERBOARD PRODUCTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Maximum Price Regulation No. 187 is amended in the following respects:

1. In section 1 (c) (3) (viii) the following is added:

Differentials for quantities or number of colors of ink, in effect during the period October 1–31, 1941, inclusive, shall apply.

2. In Appendix A, paragraphs (b) and (c) are added to read as follows:

(b) Where a manufacturer has established the practice of pricing a group of commodities and/or services by a price list under paragraph (a) above, and if the manufacturer is unable to determine a maximum price for a commodity and/or service under paragraph (a) above, the manufacturer shall:

(1) Select the most comparable commodity and/or service for which a maximum price has been established under paragraph (a) above;

(2) Divide his maximum price for the most comparable commodity and/or service by its current direct cost;

(3) Multiply the percentage so obtained by the current direct cost of the commodity and/or service being priced.

"Comparable commodity and/or service" means the commodity and/or service furnished by the same manufacturer and made on the same converting equipment, which differs the least from the commodity and/or service to be priced as determined by the use of the following tests: (a) style; (b) shape; (c) type of materials; (d) size; (e) addition or subtraction of parts or partitions. These tests must be applied successively and each is to be applied to the commodity or group of commodities determined by the application of the preceding test. A change in color of ink or a change in printing copy shall not affect the comparability of the commodity and/or service.

"Direct cost" means the sum of direct labor and direct material costs. Direct labor shall in no event be computed on wage rates higher than permitted by law, and direct material shall in no event be computed on prices higher than the maximum prices established by the applicable maximum price regulations.

Within ten (10) days after determining a maximum price for a commodity and/or service under this paragraph (b), the manufacturer shall report such price to the Office of Price Administration, Washington, D. C., together with a statement setting forth all relevant facts used in arriving at such maximum price. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.

(c) If the manufacturer is unable to determine a maximum price for a commodity and/or service under paragraphs (a) or (b) above, he shall file an application for approval of a maximum price with the Paper and Paper Products Branch, Office of Price Administration, Washington, D. C. The application shall set forth:

(1) A description of the commodity and /or service for which a maximum price is sought;

(2) The reason why such commodity and/or service cannot be priced under paragraphs (a) or (b) above;

(3) The maximum price proposed by the manufacturer, together with a detailed explanation of the method by which the manufacturer calculated such price;

(4) The reasons why the manufacturer believes the proposed price to be in line with the level of maximum prices established by this regulation; and

(5) The manufacturer shall also submit such additional pertinent information as this Office may require.

Unless the Office of Price Administration or a duly authorized representative thereof shall, by letter mailed to the applicant within 21 days from the filing of such application approve, disapprove, adjust, amend, or extend the time within which to do any of the foregoing, such application shall be deemed to have been approved, subject to non-retroactive written disapproval or adjustment at any later time by the Office of Price Administration.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; and E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1561; Filed, January 31, 1944; 11:48 a. m.]

PART 1347—PAPER, PAPER PRODUCTS, RAW MATERIALS FOR PAPER AND PAPER PRODUCTS, PRINTING AND PUBLISHING

[RMPR 464,[1] Amdt. 1]

PULPWOOD PRODUCED IN DESIGNATED STATES

A statement of the considerations involved in the issuance of this Amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Maximum Price Regulation No. 464 is amended in the following respects:

1. In section 8 (a), subparagraphs (7) and (14) are amended to read as follows:

(7) "Rough pulpwood" means pulpwood from which the bark has not been removed except that when rough pulpwood is produced in the Counties of Elk, Forest, McKean, Potter, Tioga, Warren, Jefferson, Lycoming and Wayne in the State of Pennsylvania, rough pulpwood shall also be sawn at both ends, full fifty-two (52) inches long, and round with a minimum diameter of six (6) inches;

(14) "Zone II" includes the State of Maryland, the Counties of Pendleton, Grant, Mineral, Hardy, Morgan, Hampshire, Berkeley, and Jefferson in the State of West Virginia and the State of Delaware.

2. In Appendix B (a), subparagraph (1) is amended to read as follows:

(1) The maximum price per cord for pulpwood cut from the stump in Zone II shall not exceed $9.60 for rough wood; and $12.80 for peeled wood, f. o. b. cars, banked down at a barge landing, or delivered to mill by truck. However, when pulpwood, other than that produced in the State of Delaware, is delivered to a consumer by truck or similar vehicle, an amount not in excess of $2.40 per cord may be added to the maximum price for wood delivered f. o. b. cars as hereinabove set forth. Where pulpwood is loaded on a barge by or at the expense of the seller, an amount not in excess of $1.00 per cord may be added to the maximum price at the landing.

3. In Appendix F, paragraph (b) is amended to read as follows:

(b) *Dealers.* In the event that a consumer of pulpwood shall purchase pulpwood through a dealer as defined in section 8 (a) (10) hereof, such consumer may pay such dealer not more than the maximum price hereinbefore established, plus a dealer's allowance not in excess of 50¢ per cord for both rough and peeled wood, except if the pulpwood is produced in the States of Indiana, Illinois and Missouri, in which case the consumer may pay such dealer not more than the maximum price hereinbefore es-

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 14395, 17367.

[1] 8 F.R. 12092, 12515, 14074, 14278.

tablished, plus a dealer's allowance not in excess of $1.00 per cord for both rough and peeled wood.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1565; Filed, January 31, 1944; 11:50 a. m.]

PART 1394—RATIONING OF FUEL AND FUEL PRODUCTS

[RO 5E,[1] Amdt. 3]

MILEAGE RATIONING: GASOLINE REGULATIONS FOR PUERTO RICO

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 5E is amended in the following respect:

Section 2.19 (d) is amended to read as follows:

(d) Each dealer shall deliver all "zafra" certificates in his possession in accordance with the provisions of section 7.16 to the Board having jurisdiction not later than 4:00 p. m. Saturday of the week during which such transfer of gasoline was made and shall receive an exchange certificate (Form OPA R-548) in exchange therefor.

This amendment shall become effective January 31, 1944.

(Pub. Law 871, 76th Cong., as amended by Pub. Law 89, 77th Cong., and by Pub. Law 507, 77th Cong., Pub. Law No. 421 and 729, 77th Cong., E.O. 9250, 7 F.R. 7871, WPB Directive No. 1, Supp. Dir. 1-J, 7 F.R. 562)

Issued this 26th day of January 1944.

JORGE L. CORDOVA,
Territorial Director for Puerto Rico.

Approved:

GERALD A. BARRETT,
Acting Regional Administrator, Region IX.

[F. R. Doc. 44-1557; Filed, January 31, 1944; 11:52 a. m.]

PART 1399—CONSTRUCTION, OIL FIELD, MINING AND RELATED MACHINERY

[MPR. 134,[2] Amdt. 14]

CONSTRUCTION AND ROAD MAINTENANCE EQUIPMENT RENTAL PRICES AND OPERATING OR MAINTENANCE SERVICE CHARGES

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1399.16 Appendix B of Maximum Price Regulation 134 is amended in the following respects:

1. Paragraph (a) is amended in the following respects:

a. The text of subparagraph (1) preceding the schedule, is amended to read as follows:

(1) The maximum rental price for any dump truck rented on a fully-operated basis for use on construction or road maintenance work (including other uses to which it may be assigned in the course of a rental that is primarily for construction or road maintenance work), shall be a price calculated on the basis of the hours of actual use of such truck multiplied by an hourly rate which is the sum of (i) the applicable charge per hour, according to the capacity of such truck, set forth in the following Schedule, plus (ii) 135% of the hourly wage for the operator of such truck at the rate prevailing on March 31, 1942 in the area of the job site. "Rate" or "rates" as used in this paragraph means the sum of the aforesaid items. Where the rental is on a fully-operated basis excepting only a driver, the maximum rental price may be computed by multiplying the number of hours of actual use by the applicable charge per hour set forth in the following schedule, as an alternative to the method set forth in paragraph (b) (5) of this section.

b. The heading "charge per hour (less operator's wages)" in the schedule of subparagraph (1) is amended to read as follows: "charge per hour (not including operator's wages)".

c. The first sentence of subparagraph (2) is amended to read as follows: "The capacity of any dump truck shall be the water level capacity as determined by the height of the tail gate or front end, whichever is lower, of the permanent body of the truck: *Provided*, That when necessary to attain such water-level the sides of the truck are brought up to this height, whether by temporary or permanent additions."

d. Subparagraph (2) is further amended by adding a new sentence to read as follows: "The capacity of the Boulder type dump truck shall be determined by the manufacturer's rating."

e. In subparagraph (7) the words "as beginning from the time the truck arrives" _____ are amended to read as follows: _____ "as beginning not sooner than the time the truck arrives _____."

2. The text of paragraph (b) (1) preceding the schedule is amended to read as follows:

(1) The maximum rental price for any dump truck rented on a bare basis for use on construction or road maintenance work (including other uses to which it may be assigned in the course of a rental that is primarily for construction or road maintenance work), shall be a price calculated on the basis of a monthly rate equal to the applicable percentage, according to the value of such truck as set forth in the schedule below, of the highest maximum price (exclusive of any allowance for storage and maintenance) established by any regulation issued by the Office of Price Administration for the sale to any domestic class of purchasers of the nearest equivalent new dump truck, or the nearest equivalent new truck chassis and the nearest equivalent new extra, special, or optional equipment which may have been added to complete the truck. The maximum rate per week shall not exceed 1/3 of the maximum rate per month; the maximum rate per day shall not exceed 1/12 of the maximum rate per month.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1560; Filed, January 31, 1944; 11:48 a. m.]

PART 1400—TEXTILE FABRICS: COTTON, WOOL, SILK, SYNTHETIC AND ADMIXTURES

[MPR 478,[1] Amdt. 2]

COATED AND COMBINED FABRICS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation 478 is amended in the following respects:

1. In section 1 (c), the text preceding subparagraph (1) is amended to read as follows: "This regulation applies to any manufacturer or wholesaler of coated or combined fabrics. A person may be a manufacturer as to certain fabrics and a wholesaler as to others, depending upon the functions that he performs with respect to the fabric in question. When used in this regulation, the term:"

2. Section 6 (a) (3) is added to read as follows:

(3) Fabrics which are used in the production of combat vehicles or airplanes specifically designed for military use and services rendered on such fabrics.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1555; Filed, January 31, 1944; 11:52 a. m.]

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*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 9975.

[2] 7 F.R. 3203, 3411, 3447, 7001, 8386, 9054, 8948, 9785, 8 F.R. 1975, 3789, 5931, 9140, 10759, 12544, 13127.

[1] 8 F.R. 14080.

PART 1426—WOOD PRESERVATION AND PRIMARY FOREST PRODUCTS

[RMPR 324,[1] Amdt. 2]

FENCE POSTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Maximum Price Regulation No. 324 is amended in the following respects:

1. Section 2 is amended to read as follows:

SEC. 2. *Purpose and coverage of this regulation.* (a) This regulation establishes specific maximum prices for all sales of fence posts of the species listed below. Species not listed remain subject to the General Maximum Price Regulation,[2] except on sales by retail yards which are covered in section 3. The "species" includes also some limitations as to the area in which the posts are produced. The species covered are:

(1) Northern White Cedar (Thuja occidentalis), produced in the States of Michigan, Minnesota, Wisconsin, Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, and Vermont.

(2) Yellow pine, including shortleaf pine (Pinus echinata), loblolly pine (Pinus taeda), slash pine (Pinus caribaea), or longleaf pine (Pinus palustris), and any other species commercially known as Southern yellow pine, produced at any point in the United States.

(3) Arkansas red cedar (Juniperus virginiana) produced in Arkansas, Louisiana, Oklahoma, and Missouri.

(4) Tennessee red cedar (Juniperus virginiana) produced in Tennessee, Alabama, Kentucky, Virginia, Georgia, North Carolina, South Carolina, West Virginia, Indiana, and Ohio.

(5) Texas mountain cedar (Juniperus mexicana and Juniperus pinchotii) produced in Texas and Oklahoma.

(6) Black locust (Robinia pseudoacacia) produced in Arkansas.

(7) All species of oak (Quercus) produced in Arkansas.

(8) Western Red cedar (Thuja plicata) produced in Idaho, Montana, and those parts of Oregon and Washington lying east of the crest of the Cascade Mountains.

(9) Redwood (Sequoia sempervirens) produced in California.

(b) The term "fence posts" as used in this regulation includes fence posts and stakes, round or split, peeled or unpeeled, untreated or treated. Material may be sold under this regulation as a "fence post" only if it is not greater than eight inches in diameter nor longer than 14 feet and for actual end use as support for fencing. "Diameter" refers to the diameter measured under the bark.

(c) All posts priced in this regulation must be of sound live timber free of decay, splits, large or numerous knots or knot holes, etc., that would impair strength or durability, except other grades specifically priced in the tables of section 4.

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 2027, 3367, 6869, 10436.

[2] 8 F.R. 3096, 3849, 4347, 4486, 4724, 4848, 4978, 6047, 6962, 8511, 9025, 9991, 11955, 13924.

2. Section 3 is amended to read as follows:

SEC. 3. *How to figure maximum prices.* (a) The maximum prices for posts of the listed species for all sales except sales by distributors to retailers, sales out of retail yards, and sales to industrial users, are shown in the tables in section 4.

(b) *Maximum prices for distributors' sales to retail yards.* On sales by a distributor to a retailer, the maximum prices for untreated posts shown in section 4 may be increased 15 percent: *Provided,* The sale is in less-than-carload quantity, and the distributor's stock from which the sale is made is maintained outside the normal production area of the species sold.

NOTE: Retailers buying posts under this provision and reselling to consumers are still limited to resale prices determined according to paragraph (c) below.

(c) *Maximum prices for retail yard sales.* A "retail yard" under this regulation is a wholesale or retail lumber yard or other retail business which gets fence posts from producers, concentrators, or wholesalers; unloads, stores, and resells them to consumers; which regularly maintains a stock of merchandise including fence posts; which sells mostly for local delivery by truck; and which has been located at its particular site in order to be near a consuming area. The maximum prices for retail yard sales of fence posts, treated or untreated, shall be determined as follows:

(1) *Listed species; untreated or treated by nonpressure methods:*

(i) The maximum price from section 4 for the same size and species of post, plus

(ii) An addition for inbound freight computed by multiplying the appropriate estimated weight given in section 4 by the carload freight rate from the basing point given for that species which produces the lowest rate to the seller's retail yard, plus

(iii) A mark-up of 33⅓ percent to the total of (i) and (ii), except that on yellow pine posts the percentage mark-up is limited to 25 percent.

(2) *Listed species; pressure treated:*

(i) The maximum price from section 4 for the same size and species of post, plus

(ii) The appropriate addition for pressure treatment shown in Maximum Price Regulation 491, section 19 (c), table 3,[3] plus

[3] For convenience, this schedule of additions for pressure treatment is shown herein, as follows:

Diameter at small end	Length	MPR 491 Addition for Pressure Treatment
	Feet	
2½" round	6	$0.11
3" round	6	.15
3½" round	6	.20
4" round	6	.25
4½" round	6	.30
5" round	6	.415
6" round	6	.575
2½" round	6½	.12
3" round	6½	.165
3½" round	6½	.215
4" round	6½	.27

(iii) An addition for freight computed by multiplying the appropriate estimated weight given in section 4 by the carload freight rate from the basing point given for that species which produces the lowest rate to the seller's retail yard, plus

(iv) A mark-up of 25 percent to the total of (i), (ii), and (iii).

NOTE: These treating additions are per piece and include preservative required to obtain a final retention of six pounds per cubic foot with grade one creosote oil. On any other specification of treatment the original seller must have secured approval of an addition under section 8 of Maximum Price Regulation 491. The addition so authorized for his supplier must be used by the retail yard in figuring the maximum price. If this cannot be ascertained, the retail yard must

Diameter at small end	Length	MPR 491 Addition for Pressure Treatment
	Feet	
4½" round	6½	$0.325
5" round	6½	.45
6" round	6½	.62
2½" round	7	.13
3" round	7	.175
3½" round	7	.235
4" round	7	.29
4½" round	7	.35
5" round	7	.485
6" round	7	.67
2½" round	8	.15
3" round	8	.205
3½" round	8	.265
4" round	8	.33
4½" round	8	.45
5" round	8	.55
6" round	8	.795
7" round	8	1.05
8" round	8	1.35
7" round	9	1.20
8" round	9	1.50
3" round	10	.28
3½" round	10	.35
4" round	10	.48
4½" round	10	.55
5" round	10	.77
6" round	10	1.00
7" round	10	1.35
8" round	10	1.70
3" round	12	.35
3½" round	12	.42
4" round	12	.575
4½" round	12	.68
5" round	12	.945
6" round	12	1.20
3" round	14	.40
3½" round	14	.49
4" round	14	.67
4½" round	14	.80
5" round	14	1.02
6" round	14	1.40
4" halves	6	.13
4½" halves	6	.165
5" halves	6	.195
5½" halves	6	.235
6" halves	6	.30
4" halves	6½	.14
4½" halves	6½	.175
5" halves	6½	.21
5½" halves	6½	.255
6" halves	6½	.325
4" halves	7	.15
4½" halves	7	.19
5" halves	7	.23
5½" halves	7	.275
6" halves	7	.35
4" halves	8	.175
4½" halves	8	.22
5" halves	8	.265
5½" halves	8	.31
6" halves	8	.40
7" face quarters	6½	.21
8" face quarters	6½	.29
7" face quarters	7	.23
8" face quarters	7	.33

apply for approval of an addition according to section 6 of Revised Maximum Price Regulation 324.

(3) *Species not listed; treated or untreated:*

(i) The General Maximum Price Regulation price of the supplier from whom the posts are bought, plus

(ii) Actual transportation costs from the supplier's shipping point to the retail yard, plus

(iii) A mark-up of 33⅓ percent to the total of (i) and (ii).

(4) *Delivery charges.* The maximum prices for retail yard sales established under this paragraph (c) include free delivery within the mileage limits and to those classes of customers to whom free delivery was extended in March 1942. On retail-yard sales to those classes of customers to whom free delivery was not included in March 1942, an additional charge for delivery may be made, according to (i) or (ii) below.

(i) *Private truck.* When delivery is by truck owned or controlled by the seller, the amount added for delivery may not be more than the actual cost to the seller of delivery by truck. This "actual cost" may not be higher than the over-all average trucking cost for a similar delivery arrived at as of the 12-month period ending December 31, 1942.

(ii) *Common or contract carrier.* When delivery is made by common or contract carrier only the actual amount paid to the carrier for transportation of the fence posts may be added.

(d) *Maximum prices for sales to industrial users.* Industrial users for the purpose of this regulation are federal, state, and municipal governments, industrial plants, and transportation systems, which use fence posts for the protection and maintenance of their properties. The maximum prices for sales of fence posts to an industrial user shall be determined as follows:

(1) *Listed species; untreated or treated by nonpressure methods:*

(i) The maximum price from section 4, plus

(ii) An addition for freight computed by multiplying the appropriate estimated weight given in section 4 by the carload freight rate from the basing point given for that species which is nearest the seller's shipping point, plus

(iii) A mark-up of 15 percent to the total of (i) and (ii).

(2) *Listed species, pressure treated:*

(i) The maximum price from section 4 for the same size and species of post, plus

(ii) The appropriate additions for pressure treatment shown in Maximum Price Regulation 491, section 19 (c), Table 3 (see note under paragraph (c)), plus

(iii) An addition for freight computed by multiplying the appropriate estimated weight given in section 4 by the carload freight rate from the basing point given for that species which is nearest the seller's shipping point.

(3) *Species not listed; treated or untreated:* The seller's General Maximum Price Regulation price including delivery to destination shall apply.

plying to "3" Round 8'", the figure ".17" is changed to ".19".

3. In section 4, Table 1, in the line ap-

4. In section 4, Table 4 is amended to read as follows:

TABLE 4.—TENNESSEE RED CEDAR

Species: Red Cedar (Juniperus virginiana) produced in Tennessee, Alabama, Kentucky, Virginia, Georgia, North Carolina, South Carolina, West Virginia, Indiana, and Ohio. Basing Point: Murfreesboro, Tennessee.

[F. o. b. loading-out point]

Diameter at small end (except on quarters which are measured by width of flat side)	Length	Price each post	Estimated weights (lbs. per post)
	Feet		
2" round	6½	$0.08	11.5
2½" round	6½	.12	17.5
3" round	6½	.14	23
4" round	6½	.23	35
5" round	6½	.29	46
2" round	7	.085	14
2½" round	7	.13	19.5
3" round	7	.155	25
4" round	7	.25	38
5" round	7	.39	52
6" round	7	.67	75
3" round	8	.20	30
4" round	8	.33	44
5" round	8	.46	57
6" round	8	.74	86
7" round	8	1.24	126
8" round	8	1.57	172
6" round	9	.98	101
7" round	9	1.42	150
8" round	9	1.84	184
4" round	10	.43	52
5" round	10	.66	75
6" round	10	1.11	115
7" round	10	1.63	173
8" round	10	2.50	196
4" round	12	.53	69
5" round	12	.90	98
6" round	12	1.28	144
4" round	14	.67	92
5" round	14	1.13	121
6" round	14	1.57	173
3" to 3½" slabbed one side	6½	.19	23
3½" to 5" slabbed one side	6½	.25	30
3" to 3½" slabbed one side	7	.20	25
3½" to 5" slabbed one side	7	.26	37
3½" to 5" slabbed one side	8	.31	46
5" face sawn or split halves	6½	.19	21
6" face sawn or split halves	6½	.26	35
7" face sawn or split halves	6½	.40	46
5" face sawn or split halves	7	.20	23
6" face sawn or split halves	7	.27	38
7" face sawn or split halves	7	.44	52
6" face sawn or split halves	8	.37	44
7" face sawn or split halves	8	.52	57.5
3" to 3½" axe hewn four sides	6½	.22	21
3½" to 4" axe hewn four sides	6½	.26	25
4" to 5" axe hewn four sides	6½	.27	35
3" to 3½" axe hewn four sides	7	.23	24
3½" to 4" axe hewn four sides	7	.27	29
4" to 5" axe hewn four sides	7	.30	37
5" to 6" axe hewn four sides	7	.54	52
3" to 3½" axe hewn four sides	7½	.24	26
3" to 3½" axe hewn four sides	8	.28	29
3½" to 4" axe hewn four sides	8	.28	35
4" to 5" axe hewn four sides	8	.48	41
5" to 6" axe hewn four sides	8	.62	58
6" to 7" axe hewn four sides	8	1.29	96
7" to 8" axe hewn four sides	8	1.80	115
8" to 9" axe hewn four sides	8	2.33	138
5" to 6" axe hewn four sides	9	.79	69
6" to 7" axe hewn four sides	9	1.47	92
7" to 8" axe hewn four sides	9	1.86	127
8" to 9" axe hewn four sides	9	2.51	161
3½" to 4" axe hewn four sides	10	.56	46
4" to 5" axe hewn four sides	10	.67	58
5" to 6" axe hewn four sides	10	.89	86
6" to 7" axe hewn four sides	10	1.62	109
7" to 8" axe hewn four sides	10	2.08	138
8" to 9" axe hewn four sides	10	2.65	196

redesignated Tables 10 and 11, respec-

5. In section 4, Tables 9 and 10 are tively, and a new Table 9 is inserted to read as follows:

TABLE 9.—NORTHERN WHITE CEDAR—NEW ENGLAND

Species: Northern White Cedar (Thuja Occidentalis) produced in New York, Vermont, New Hampshire, Massachusetts, Connecticut, Rhode Island, and Maine.
Basing Point: Dover-Foxcroft, Maine.

[F. o. b. loading-out point]

Diameter at small end	Length	Price each post	Estimated weight (lbs. per post)
	Feet		
3"	6	$0.18	18
4"	6	.21	30
5"	6	.24	42
6"	6	.30	60
3"	7	.21	21
4"	7	.245	35
5"	7	.28	49
6"	7	.35	70
3"	8	.24	24
4"	8	.28	40
5"	8	.32	56
6"	8	.40	80
3"	10	.30	30
4"	10	.35	50
5"	10	.40	70
6"	10	.50	90
3"	12	.36	36
4"	12	.42	60
5"	12	.48	96
6"	12	.60	120

6. Section 5 is amended to read as follows:

SEC. 5. *Transportation addition.* (a) Except as specially provided in section 3 (a) (2), covering retail-yard sales, additions for transportation shall be computed from the applicable basing point specified in the heading of the appropriate price table. In the case of Northern white cedar (Table 1) and yellow pine (Table 2), where more than one basing point is given, the applicable basing point is the one nearest the shipper's actual loading-out point.

(b) When the estimated weights in the tables of section 4 are used, the weight times the carload railroad freight rate from the applicable basing point to the actual destination is the maximum permissible addition, even if the estimated weights are higher than the actual weights.

(c) When estimated weights are not used, the maximum addition for transportation is the actual weight times the carload railroad freight rate from the applicable basing point to destination.

7. Section 7 is amended to read as follows:

SEC. 7. *Treated posts.* Pressure-type preservative treatment additions are established by Maximum Price Regulation 491, section 19 (c), Table 3. On sales of posts of the listed species which are treated by methods other than pressure process, an addition may be made to the maximum prices contained in section 4, figured according to section 6 of this regulation. Posts of unlisted species, treated by any method, remain under the GMPR, except as covered in section 3 for retail-yard sales.

8. In section 8, the phrase "at retail" is substituted in place of the phrase "to consumers".

9. In section 9, the following sentence is added: "It is a direct violation to buy or sell material as fence posts under and according to the provisions of this regu-

lation, for use as saw-logs or for any other purpose than as support for fencing."

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1553; Filed, January 31, 1944; 11:51 a. m.]

PART 1499—COMMODITIES AND SERVICES

[Rev. SR 14 to GMPR, Amdt. 88]

CALCIUM CARBIDE

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 4.16 (a) is amended to read as follows:

(a) *Maximum prices.* Maximum prices for sales and deliveries of calcium carbide are established as follows:

Grade and class of purchaser	Container	Quantity of shipment	Maximum price per ton
(1) Generator grades or mixed grades:			
(i) For domestic use:			
(*a*) Industrial customers not receiving allocations.	100 lb. drums	LCL	$95.00, delivered warehouse cities.
(*b*) Industrial customers receiving allocations.	100 lb. drums	LCL	$93.00, delivered warehouse cities.
	100 lb. drums	CL	$87.00, delivered purchaser's siding.
	All other containers	CL	$85.00, delivered purchaser's siding.
(*c*) Shipyards			Appropriate price specified in (*a*) or (*b*) less $1.00 per ton.
(*d*) Acetylene plants	100 lb. drums	CL	$67.00, f. o. b. producing point.
	All other containers	CL	$65.00, f. o. b. producing point.
(*e*) Chemical plants allocated more than 50 tons per month.	100 lb. drums	CL	$57.00, f. o. b. producing point.
	250–400 lb. drums	CL	$55.00, f. o. b. producing point.
	600–1,100 lb. drums	CL	$53.00, f. o. b. producing point.
	5-ton bulk containers	CL	$50.00, f. o. b. producing point.
(ii) For export	100 lb. drums	CL	$80.00, f. o. b. producing point.
	100 lb. drums	LCL	Appropriate price specified in (i) (*a*) or (*b*).
(2) Rice and 14ND			Appropriate price specified in (1) plus $7.00 per ton.
(3) Fines—all purchasers	All containers	CL	$55.00, f. o. b. producing point.

The above prices for sales in containers of 400 lbs. or less include containers. On sales in containers of more than 400 lbs., the above prices do not include containers.

This amendment shall become effective February 5, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1563; Filed, January 31, 1944; 11:49 a. m.]

PART 1448—EATING AND DRINKING ESTABLISHMENTS

[Restaurant MPR 5–9, Amdt. 1]

FOOD AND DRINK SOLD FOR IMMEDIATE CONSUMPTION IN NEW ORLEANS, LA., DISTRICT

For the reasons set forth in the statement of considerations issued simultaneously herewith, Restaurant Maximum Price Regulation No. 5–9 is hereby amended in the following respects:

1. Section 18 is amended by the addition of a paragraph (j) reading as follows:

(j) Eating and drinking places operated on a non-profit basis by the State of Louisiana or any agency thereof.

2. The first paragraph of section 19 (b) is amended to read as follows:

(b) If you are the proprietor of an eating establishment which satisfies the requirements specified above, you may apply for an adjustment of your maximum prices by submitting in duplicate to the New Orleans District Office of the Office of Price Administration, 708 Canal Building, New Orleans, Louisiana, a statement setting forth:

This amendment shall become effective January 17, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681; Gen. Order 50, 8 F.R. 4508)

Issued this 17th day of January 1944.

GILBERT J. FORTIER,
District Director,
New Orleans District.

[F. R. Doc. 44–1573; Filed, January 31, 1944; 4:11 p. m.]

PART 1499—COMMODITIES AND SERVICES

[Order 29 Under § 1499.3 (c) to GMPR]

UNIT STRUCTURES, INC.

For the reasons set forth in an opinion issued simultaneously herewith and filed with the Division of the Federal Register,* and pursuant to and under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, as amended, and Executive Orders Nos. 9250 and 9328, and in accordance with § 1499.3 (c) of the General Maximum Price Regulation, it is hereby ordered:

§ 1499.826 *Authorization of maximum prices for sales to dealers of certain prefabricated farm buildings and accessories manufactured by Unit Structure, Inc.* (a) The maximum prices for sales to dealers of the types and descriptions of certain prefabricated farm buildings and accessories manufactured by Unit Structures, Inc., of Peshtigo, Wisconsin, listed below, and contained in the price list of August 21, 1943, filed with the Office of Price Administration by the National Ideal Company of Toledo, Ohio, and sold to dealers by any person, shall be as follows:

PREMIER FARM BUILDINGS

U–12 X Brooder House	$111.80
U–12 R Brooder House	127.60
U–12 SR Brooder House	135.60
U–40 Frame Assembly	26.20
UG Rafters (Repair Item)	3.40
X–10 Brooder House	121.20
X–15 Brooder House	164.00
X–20 Brooder House	206.80
XS–1 5 Ft. Section	42.80
XS–2 10 Ft. Section	85.60
UL–20F Laying House	293.20
UL–20 Laying House	238.00
UL–30F Laying House	404.80
UL–30 Laying House	319.80
UL–40F Laying House	515.60
UL–40 Laying House	401.60
410 (2) Dropping Boards	12.60

MASONITE CELL-U-BLANKET FOR:

UL–20 Laying House	$31.04
UL–30 Laying House	38.88
UL–40 Laying House	46.72
X–10 Brooder House	11.88
X–15 Brooder House	15.20
X–20 Brooder House	18.48
U–12 Series Brooder Houses	16.56

All prices are f. o. b. Peshtigo, Wisconsin, or Sayville, New York.

(b) This Order No. 29 may be revoked or amended by the Price Administrator at any time.

This Order No. 29 shall become effective February 1, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1558; Filed, January 31, 1944; 11:49 a. m.]

PART 1340—FUEL

[MPR 112, Amdt. 17]

PENNSYLVANIA ANTHRACITE

A statement of consideration involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1340.200 (a) (6) is added to read as follows:

(6) The maximum prices for all anthracite loaded at the mine or preparation plant into railroad cars or trucks during the month of February, 1944 for delivery to destination may be increased by a sum not to exceed 45 cents per net ton. On and after March 1, 1944 the maximum prices for such anthracite shall revert to the maximum prices as

*Copies may be obtained from the Office of Price Administration.

established by subparagraphs 1, 2, 3, 4 and 5 of this section or by an order of adjustment issued prior to February 1, 1944.

This amendment shall become effective February 1, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1572; Filed, January 31, 1944; 4:11 p. m.]

PART 1351—FOOD AND FOOD PRODUCTS

[2d Rev. MPR 270,[1] Amdt. 2]

DRY EDIBLE BEANS, AND CERTAIN OTHER DRY FOOD COMMODITIES

A statement of the considerations involved in the issuance of this amendment has been issued and filed with the Division of the Federal Register.*

Section 6 is amended to read as follows:

SEC. 6. *Packaging allowances.* For listed food commodities packed in the following containers, additional amounts shall be included in base prices as follows:

	Per cwt.
Up to and including 1 lb	$2.05
Over 1 lb. up to and including 2 lbs	1.65
Over 2 lbs. up to and including 3 lbs	1.35
Over 3 lbs. up to and including 5 lbs	1.10
Over 5 lbs. up to and including 25 lbs	.50
Over 25 lbs. up to and including 50 lbs	.25
Over 50 lbs	Nothing

This amendment shall become effective January 31, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

Approved: January 29, 1944.

ASHLEY SELLERS,
Assistant War Food Administrator.

[F. R. Doc. 44-1571; Filed, January 31, 1944; 4:11 p. m.]

PART 1448—EATING AND DRINKING ESTABLISHMENTS

[Restaurant MPR 3-1, Revocation]

FOOD AND DRINK SOLD FOR IMMEDIATE CONSUMPTION IN JEFFERSON COUNTY, KY.

For the reasons set forth in a statement of considerations issued simultaneously herewith and under the authority vested in the Regional Administrator of Region III by the Emergency Price Control Act of 1942, as amended, Executive Order No. 9250, Executive Order No. 9328, and General Order No. 50 issued by the Office of Price Administration, it is ordered that Restaurant Maximum Price Regulation No. 3-1 entitled "Food and Drink Sold for Immediate Consumption, Jefferson County, Kentucky" be, and the same is, hereby revoked.

The provisions of Supplementary Order No. 40, "Effect of Repeal. Revocation, Amendment or other Modifications of Price Regulations" issued by the Price Administrator on April 2, 1943, shall apply with full force and effect to this order of revocation.

(56 Stat. 23, 765; Pub. Laws 151, 78th Cong.; E.O. 9250, 7 F.R. 7871 and E.O. 9328, 8 F.R. 4681)

Issued and effective February 1, 1944.

BIRKETT L. WILLIAMS,
Regional Administrator.

[F. R. Doc. 44-1605; Filed, February 1, 1944; 11:54 a. m.]

PART 1305—ADMINISTRATION

[Gen. RO 8,[1] Amdt. 5]

COUNTERFEITED OR FORGED RATION DOCUMENT

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 2.5 is amended to read as follows:

SEC. 2.5 *Acquisition, use, transfer or possession of counterfeited or forged ration document.* (a) No person shall acquire, use, permit the use of, transfer, possess or control any counterfeited or forged ration document under circumstances which would be in violation of section 2.6 if the document were genuine or if he knows or has reason to believe that it is counterfeited or forged.

This amendment shall become effective February 5, 1944.

(Pub. Law 671, 76th Cong. as amended by Pub. Laws 89, 421, 507 and 729, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9334, 8 F.R. 5423; WPB Dir. 1, 7 F.R. 562; Sec. of Agr. Food Dir. 3, 8 F.R. 2005, Food Dir. 5, 8 F.R. 2251, Food Dir. 6, 8 F.R. 3471, Food Dir. 7, 8 F.R. 3471, Food Dir. 8, 8 F.R. 7093)

[1] 8 F.R. 3783, 5677, 9626, 15455.

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1604; Filed, February 1, 1944; 11:55 a. m.]

PART 1314—RAW MATERIALS FOR SHOES AND LEATHER PRODUCTS

[RPS 9,[1] Amdt. 8]

HIDES, KIPS AND CALFSKINS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Price Schedule No. 9, as amended, is amended in the following respects:

The effective date of Amendment 3 is hereby postponed from February 1, 1944 to June 1, 1944.

This amendment shall become effective February 1, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1603; Filed, February 1, 1944; 11:55 a. m.]

PART 1364—FRESH, CURED AND CANNED MEAT AND FISH PRODUCTS

[MPR 418,[2] Amdt. 21]

FRESH FISH AND SEAFOOD

A statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and filed with the Division of the Federal Register.*

Maximum Price Regulation No. 418 is amended in the following respects:

1. In section 20, Table A, the prices per pound for Schedule Nos. 14 and 17 during the months October through March are amended to read as follows:

[1] 7 F.R. 1227, 2000, 2132, 5706, 8948; 8 F.R. 2997, 11676, 12312, 13513, 15259, 8 F.R. 16279.

[2] 8 F.R. 9366, 10086, 10513, 10939, 11734, 11687, 12468, 12233, 12688, 13297, 13182, 13302, 14049.

TABLE A—MAXIMUM PRICES FOR PRODUCERS OF FRESH FISH AND SEAFOOD

Schedule No.	Name	Item No.	Style of dressing	Size	Price per pound, October through March	
					Bulk ex-vessel	Boxed
14	Sole, Lemon (Pseudo pleuronectes dignabilis) [1]	1	Round	All sizes	$0.16	$0.17
17	Scallops, Sea (Pecten magellanicus)	1	Meats	All sizes	.38	.39

2. In section 20, Table B, the prices per pound for Schedule Nos. 14 and 17 during the months October through March are amended to read as follows:

TABLE B—MAXIMUM PRICES FOR PRIMARY FISH SHIPPER SALES OF FRESH FISH AND SEAFOOD

Schedule No.	Name	Item No.	Style of dressing	Size	Price per pound, October through March
14	Sole, Lemon (Pseudo pleuronectes dignabilis)	1	Round	All sizes	$0.18½
17	Scallops, Sea (Pecten magellanicus)	2	Fillets	All sizes	.64
		1	Meats	All sizes	.41¾

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 16166, 17381.

3. In section 20, Table C, the prices per pound for Schedule Nos. 14 and 17 during the months October through March are amended to read as follows:

TABLE C—MAXIMUM PRICES FOR RETAILER-OWNED COOPERATIVE SALES AND SALES BY WHOLESALERS OTHER THAN PRIMARY FISH SHIPPER WHOLESALERS TO OTHER WHOLESALERS OF FRESH FISH AND SEAFOOD

Schedule No.	Name	Item No.	Style of dressing	Size	Price per pound, October through March
14	Sole, Lemon (Pseudo pleuronectes dignabilis)	1	Round	All sizes	$0.20
		2	Fillets	All sizes	.67
17	Scallops, Sea (Pecten magellanicus)	1	Meats	All sizes	.44¼

4. In section 20, Table D, the prices per pound for Schedule Nos. 14 and 17 during the months October through March are amended to read as follows:

TABLE D—MAXIMUM PRICES FOR CASH AND CARRY SALES OF FRESH FISH AND SEAFOOD

Schedule No.	Name	Item No.	Style of dressing	Size	Price per pound, October through March
14	Sole, lemon (Pseudo pleuronectes dignabilis)	1	Round	All sizes	$0.21
		2	Fillets	All sizes	.68
17	Scallops, sea (pecten magellanicus)	1	Meats	All sizes	.45¼

5. In section 20, Table E, the prices per pound for Schedule Nos. 14 and 17 during the months October through March are amended to read as follows:

TABLE E—MAXIMUM PRICES FOR SERVICE AND DELIVERY SALES OF FRESH FISH AND SEAFOOD

Schedule No.	Name	Item No.	Style of dressing	Size	Price per pound, October through March
14	Sole, Lemon (Pseudo pleuronectes dignabilis)	1	Round	All sizes	$0.23¼
		2	Fillets	All sizes	.70¼
17	Scallops, Sea (Pecten magellanicus)	1	Meats	All sizes	.47¾

This amendment shall become effective February 7, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1601; Filed, February 1, 1944; 11:54 a. m.]

PART 1394—RATIONING OF FUEL AND FUEL PRODUCTS

[RO 5C,[1] Amdt. 100]

MILEAGE RATIONING: GASOLINE REGULATIONS

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order No. 5C is amended in the following respects:

1. Section 1394.7851 (b) (2) (viii) is added to read as follows:

(viii) To transport a representative of a fertilizer manufacturer or a fertilizer mixer to the establishments of fertilizer dealers and fertilizer agents, for the purpose of arranging for the transportation of fertilizer in cooperation with the fertilizer transportation program of the War Food Administration.

(a) The applicant shall present the certification of the Chief of the Fertilizer Division, Office of Materials and Facilities, War Food Administration, stating that travel by him is necessary to the success of the War Food Administration fertilizer transportation program, and certifying the mileage needed by him for the performance of his duties in connection with such program.

(b) No ration issued under this subdivision shall be valid after May 30, 1944.

2. Section 1394.7851 (c) (4) is amended to read as follows:

(4) If application is made pursuant to paragraph (b) (1) (i) or (iii) or paragraph (b) (2) (i), (ii), (iii), (vi) or (viii) or paragraph (b) (8), or for use with a motorboat pursuant to paragraph (b) (5) (i) or (ii) of this section, the alternative means of transportation, which are available and the reasons, if any, why such alternative means are not reasonably adequate for the purpose.

3. Section 1394.7856 (c) (2) is amended to read as follows:

(2) The Board shall make a notation upon the registration card or registration certificate of such vehicle of the date of issuance and the class of ration issued.

4. In § 1394.8003 the first sentence is amended to read as follows: "At the time of issuing a gasoline ration in connection with which the presentation of a registration card is required pursuant to paragraph (a) of § 1394.8002, the person issuing such ration shall make a clear notation in ink, indelible pencil, or by typewriter, on the motor vehicle registration card or registration certificate presented by the applicant, showing the date of issuance and the class of ration issued."

5. In § 1394.8004 (e) the text preceding subparagraph (1) is amended by inserting after the words "clearly and in ink," the words "or shall write or print clearly and in indelible pencil,".

This amendment shall become effective February 5, 1944.

NOTE: The reporting requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(Pub. Law 671, 76th Cong.; as amended by Pub. Laws 89, 421 and 507, 77th Cong.; W.P.B. Dir. No. 1, Supp. Dir. No. 1Q, 7 F.R. 562, 9121; E.O. 9125, 7 F.R. 2719)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44-1597; Filed, February 1, 1944; 11:52 a. m.]

PART 1394—RATIONING OF FUEL AND FUEL PRODUCTS

[RO 5C,[1] Amdt. 101]

MILEAGE RATIONING: GASOLINE REGULATIONS

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 5C is amended in the following respects:

1. Section 1394.8006 (c) is added to read as follows:

(c) If a ration has been issued in whole or in part in the form of a gasoline deposit certificate, the renewal of such ration shall be subject to the provisions of § 1394.8051 (g).

2. Section 1394.8015 is revoked.

3. Section 1394.8017 is amended by substituting for the reference "§ 1394.8103 (e)" the reference "§ 1394.8102 (h)".

4. Section 1394.8051 (a) is amended by deleting the first sentence.

5. Section 1394.8051 (g) is added to read as follows:

(g) Notwithstanding any other provisions of this section any renewal of a ration which was issued in whole or in part in the form of a gasoline deposit certificate, shall be subject to the following provisions:

(1) The Board shall determine what amount, if any, of the former ration remains unused in the form of credits in a ration bank account as of the effective date of the renewal.

(2) The unused credits in the ration bank account, so determined by the Board, shall be available for use during the period for which the renewal ration is issued and shall be deemed a portion of the renewal ration.

(3) The Board shall subtract the amount of such unused credits from the

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 15937, 16250, 16421, 16845, 16846, 17327, 17484, 17297; 9 F.R. 286, 90.

amount of gallonage allowed for the renewal period and issue the remainder, if any, in the same manner as any other renewal.

6. Section 1394.8101 is amended to read as follows:

§ 1394.8101 *Invalidity of expired rations.* No ration evidence may be used and no ration evidence shall be valid for transfer of gasoline to a consumer after the expiration of the ration.

7. Section 1394.8102 is amended to read as follows:

§ 1394.8102 *Expiration of rations and surrender of expired rations*—(a) *Basic rations.* All Class A coupons and coupons contained in Basic Class D books shall expire at the end of the respective valid periods provided in § 1394.7652. A basic ration issued in the form of gasoline purchase permits shall expire as noted on the permits.

(b) *Supplemental, fleet, official, and similar occupational rations.* (1) The coupons and any gasoline deposit certificates representing any supplemental, fleet or official ration, or any ration issued under § 1394.7757 for a vehicle operated on interchangeable license plates, or any ration issued under § 1394.7758 for a leased rental vehicle for a period of three months shall expire on the date when a renewal of such ration becomes valid. A ration issued under § 1394.7758 for a vehicle available for public rental leased for a period of less than three months shall expire as noted on the application and the ration evidence or folder.

(2) Every supplemental ration issued for use in connection with the employment of a ration holder at a plant, establishment or facility at which an organized transportation plan has been established shall expire upon termination of the employment of the ration holder at such plant, establishment or facility, if the committee or official in charge of the organized transportation plan has been given authority to accept the surrender of expired rations. When a ration expires for this reason, all unused books and coupons representing such ration shall be surrendered immediately by the holder thereof to such committee or official or to the issuing Board. If such ration is evidenced by credits in a ration bank account, the holder shall immediately issue to such committee or official or to the issuing Board a certified ration check, payable to the Office of Price Administration for the net balance on his account representing such expired ration after deducting the aggregate gallonage of all outstanding checks. A committee or official to whom any book or ration coupons or a ration check is surrendered shall issue a receipt therefor, and promptly forward such book coupons or check to the issuing Board, or, in the event the rations for the employees are issued by more than one Board, the book, coupons or ration check shall be forwarded in such manner as may be prescribed by the District Director having jurisdiction over the area in which such plant, establishment or facility is located.

(3) Authority to accept the surrender of expired rations may be conferred upon the committee or official in charge of an organized transportation plan by the Board which has jurisdiction to issue rations for all of the employees of the plant, establishment or facility at which the plan has been established. If no Board has such jurisdiction the authority may be conferred by the District Director having jurisdiction over the area in which such plant, establishment or facility is located.

(c) *Transport rations.* (1) All transport rations represented by Class T coupons or gasoline deposit certificates shall expire at midnight of the last day of the calendar quarterly period for which they are issued.

(2) A transport ration shall also expire immediately upon revocation by the Office of Defense Transportation of any certificate of war necessity for the vehicle or vehicles for which the ration was issued.

(3) When the Office of Defense Transportation has modified a certificate of war necessity by decreasing the number of gallons of gasoline allowed under such certificate, it may determine the amount of Class T coupons or credits in a ration bank account the holder has on hand for the operation of the vehicles or vehicles for which such certificate and ration were issued for the remainder of the quarter. It may also determine what amount, if any, of such coupons or credits provide gallonage in excess of the gallonage required for the operation of such vehicle or vehicles for the remainder of the quarter under the modified certificate, and in such a case the Office of Defense Transportation shall notify the holder of the amount of such excess coupons and ration credits. Thereupon such coupons and ration credits shall immediately expire.

(4) When a ration expires under the provisions of subparagraph (1) of this paragraph it shall be surrendered, within five days after it expires, to the district office of the Office of Defense Transportation having jurisdiction with respect to the certificate of war necessity for the vehicle for which the ration was issued. When a ration expires under the provisions of subparagraphs (2) or (3) of this paragraph, it shall be surrendered immediately upon demand to a person designated by the Office of Defense Transportation for that purpose. Surrender, in any case, shall be made by the person to whom the ration was issued, or by the person in possession of the evidences or certificates which have expired. If the ration is represented by credits in a ration bank account, the holder of the ration shall make the surrender by issuing a ration check payable to the Office of Defense Transportation, equal in gallonage value to that portion of the ration which has expired. The Office of Defense Transportation shall give the ration holder a receipt for all coupons or checks surrendered under this subdivision and shall destroy such surrendered coupons. A check issued for this purpose shall not be certified. It shall be returned promptly by the person to whom it is surrendered to the bank on which it is drawn.

(d) *Special rations.* Every coupon, and any gasoline purchase permit or gasoline deposit certificates representing a special ration shall expire as noted on the applications or ration evidences.

(e) *Non-highway rations.* Every coupon, and any gasoline deposit certificate representing a non-highway ration shall expire on the date when a renewal of such ration becomes valid.

(f) *Other circumstances which cause expiration of rations: Cessation of use, change of ownership, change in circumstances of use.* (1) Every ration shall expire upon cessation of use or change of ownership of the vehicle, boat or equipment for which it was issued. The transferee of the vehicle, boat or equipment may apply for a ration therefor in his own behalf, in accordance with the applicable provisions of Ration Order 5C. However, the transferee may not obtain a ration unless a bona fide transfer is involved and he presents a duplicate copy of a receipt on Form OPA R–569 pursuant to § 1394.8017.

(2) Every ration other than a basic ration shall expire upon cessation of use of the ration for a purpose for which such ration may be obtained. Every ration other than a basic or transport ration shall expire when a change occurs in the circumstances under which the ration is being used, of such nature and duration that a ration of the same class or substantially the same quantity could not be issued under the changed circumstances. Such a change in circumstances shall be deemed to have occurred:

(i) If the person for whose use the ration was issued changes the place of his lodging, the place of employment or the route or area over which he regularly drives, so as to decrease his need for mileage;

(ii) If the ration includes preferred mileage in excess of the limitation on non-preferred mileage, and the person for whose use the ration was issued changes his occupation so that he is no longer entitled to preferred mileage.

(iii) If reasonably adequate alternative means of transportation become available for a person whose ration was issued because such means were not available;

(iv) If a person whose ration was issued on the basis of a ride-sharing arrangement fails to maintain a ride-sharing arrangement under which he carries at least four persons, including the operator, under the circumstances stated in his application.

(g) *General requirements for surrender of expired rations.* Unless otherwise provided in this section, the person to whom a ration has been issued, or any person having possession of such ration, shall, within five days after such ration expires, surrender all unused ration evidences, and credits representing such ration and any folder to the issuing Board or, upon good cause shown, to any Board. If the expired ration is evidenced by credits in a ration bank account, the person to whom it was issued shall make

such surrender by issuing an uncertified check for the net balance in such account representing such expired ration after deducting the aggregate gallonage of all outstanding checks. The check shall be made payable to the Office of Price Administration. Any check so surrendered shall be endorsed by the Board or office to which it was surrendered and returned promptly to the bank upon which it was drawn.

(h) *Issuance of receipts for rations surrendered on transfer of vehicle.* (1) Upon receiving the surrender, pursuant to paragraph (g) of this section, of all of the unused coupon books, coupons, folders and credits in a ration bank account which represent a ration for use with a motor vehicle transferred to a new owner, the Board shall issue a receipt (Form OPA R–569) in duplicate. When a Board is satisfied that the ration issued to the transferror of the vehicle has been lost, stolen or accidentally destroyed or is being wrongfully withheld from the possession of the transferor, or that no ration (whether valid or expired) issued for use with such vehicle is outstanding, or is satisfied that to refuse to issue a receipt (Form R–569) or to require surrender of such ration would cause undue hardship, the Board shall issue such a receipt in duplicate without a surrender of such coupons, books and ration checks.

(2) After December 31, 1943, any person who transfers a motor vehicle shall deliver to the transferee within two days of transfer duplicate copies of a receipt duly issued by a Board on Form OPA R–569.

(3) After December 31, 1943, the transferee of a motor vehicle, before registering the vehicle in any state for use, shall present the original copy of the receipt on Form OPA R–569 to the Registrar of Motor Vehicles. The duplicate copy of the receipt shall be submitted by the transferee of the motor vehicle to the Board pursuant to the provisions of § 1394.8017 at the time he applies for a ration for the vehicle.

(4) Any motor vehicle dealer holding for sale or resale any motor vehicle which he acquired before January 1, 1944 and for which no currently valid ration has been issued (except a special ration pursuant to the provisions of § 1394.7851 (b) (3) (i)), shall obtain duplicate copies of a receipt on Form OPA R–569 for each such vehicle held by him, by making application to the Board having jurisdiction over the area in which his dealer's establishment is located. Each such dealer shall execute in duplicate an inventory and application on Form OPA R–578 for such receipts. We shall deliver the original of such inventory and application to such Board on or after January 1, 1944, but not later than January 11, 1944, and shall retain the duplicate copy thereof until December 31, 1944. After December 31, 1943, any motor vehicle dealer who acquires a motor vehicle shall obtain duplicate copies of a receipt duly issued by a Board on Form OPA R–569 from the transferor of the vehicle at the time of transfer.

(5) Any person who scraps a motor vehicle on or after January 1, 1944 shall keep on hand for a period of twelve months at the place of business or other establishment where such vehicle was scrapped, duplicate copies of a receipt on Form OPA R–569 for every such vehicle, received by him on or after January 1, 1944.

8. Section 1394.8103 is revoked.

This amendment shall become effective February 5, 1944.

NOTE: The record keeping requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(Pub. Law 671, 76th Cong.; as amended by Pub. Laws 89, 421, 507, 77th Cong.; W.P.B. Dir. No. 1, Supp. Dir. No. 1Q, 7 F.R. 562, 9121, E.O. 9125, 7 F.R. 2719)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1598; Filed, February 1, 1944; 11:52 a. m.]

PART 1394—RATIONING OF FUEL AND FUEL PRODUCTS

[RO 11,[1] Amdt. 93]

FUEL OIL RATIONING REGULATIONS

A rationale for this amendment has been issued simultaneously herewith and has been filed with the Division of the Federal Register.*

Ration Order No. 11 is amended in the following respects:

1. Section 1394.5456 (a) is amended by adding after the period at the end of the paragraph the sentence, "However, where application is made to replace a lost or stolen coupon sheet, the Board, if it finds that extreme hardship will result if the applicant is deprived of the coupon sheet during the period the loss or theft is under investigation, may issue a coupon sheet containing enough coupons to enable the applicant to acquire fuel oil during the period of investigation (but not to exceed 30 days from the date his application was filed)."

2. Section 1394.5457 (a) is amended by substituting for the phrase "or a delivery receipt," the phrase "delivery receipt, or fuel oil deposit certificate".

3. Section 1394.5457 (b) is amended by substituting for the phrase "or a delivery receipt" the phrase "delivery receipt, or fuel oil deposit certificate".

This amendment shall become effective on February 5, 1944.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89 and 507, 77th Cong., Pub. Law 421, 77th Cong.; WPB Directive No. 1, 7 F.R. 562; Supp. Directive No. 1–O, as amended, 7 F.R. 8416; E.O. 9125, 7 F.R. 2719)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1599; Filed, February 1, 1944; 11:53 a. m.]

*Copies may be obtained from the Office of Price Administration.

[1] 7 F.R. 8480.

PART 1499—COMMODITIES AND SERVICES

[SR 14A[1] to GMPR, Amdt. 12]

DEFINITION OF "SOLD AT WHOLESALE"

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Supplementary Regulation No. 14A is amended in the following respects:

1. Section 1499.73a (a) (1) (xi) (*a*) (7) is added to read as follows:

(7) "Sold at wholesale" means a sale by any person, of fluid milk or cream in bottles or paper containers, to any person, including an industrial or commercial user, other than the ultimate consumer.

2. Section 1499.73a (a) (1a) (vi) (*d*) is added to read as follows:

(*d*) "Sold at wholesale" means a sale, by any person, of ice cream mix whose butterfat content is reduced to not less than 8% included in 14% or more (by weight) of milk solids, and of ice cream, to any person, including an industrial or commercial user, other than the ultimate consumer.

This amendment shall become effective February 7, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1600; Filed, February 1, 1944; 11:53 a. m.]

TITLE 49—TRANSPORTATION AND RAILROADS

Chapter II—Office of Defense Transportation

[General Permit ODT 35–2]

PART 521—CONSERVATION OF MOTOR EQUIPMENT PERMITS

LOCAL PASSENGER TRANSPORTATION EQUIPMENT

In accordance with § 501.308 of General Order ODT 35, it is hereby authorized that:

§ 521.5201 *Certain operations authorized.* Notwithstanding the provisions of § 501.307 of General Order ODT 35 the Department of War may use and operate local passenger transportation equipment (a) for the movement of military personnel on maneuvers or on trips made on official military orders, or (b) on special operations necessary for the prosecution of the war.

This General Permit ODT 35–2 shall become effective February 1, 1944.

[1] 8 F.R. 9885, 10514, 12793, 13060, 13724, 15259, 15705, 16604, 16428, 16919, 17199.

(E.O. 8989, as amended, 9156, 9294; 6 F.R. 6725 and 8 F.R. 14183, 7 F.R. 3349, 8 F.R. 221; General Order ODT 35, 8 F.R. 3451)

Issued at Washington, D. C., this 1st day of February 1944.

JOSEPH B. EASTMAN,
Director,
Office of Defense Transportation.

[F. R. Doc. 44-1580; Filed, February 1, 1944; 10:42 a. m.]

Notices

DEPARTMENT OF THE INTERIOR.

Coal Mines Administration.

[Order No. CMA-17]

BILLMAN COAL CO.

ORDER TERMINATING GOVERNMENT POSSESSION

I have been advised that certain adjustments have been made in the terms and conditions of employment at the coal mines of the Billman Coal Company, 900 Ninth Street SW., Canton, Ohio, which adjustments were approved by the National War Labor Board on January 11, 1944, and that there no longer exist any work stoppages or threats of work stoppages because of labor disputes at said mines.

Based upon such information, and after consideration of all the circumstances, I find that in accordance with the provisions of the War Labor Disputes Act of June 25, 1943 (Pub. No. 89, 78th Cong., 1st Sess.) possession by the Government of such mines should be terminated.

Accordingly, I order and direct that the possession by the Government of the mines of the said Billman Coal Company, including any and all real and personal property, franchises, rights, facilities, funds, and other assets used in connection with the operation of such mines be, and it is hereby, terminated and that there be conspicuously displayed at those mining properties copies of a poster to be supplied by the Coal Mines Administration and reading as follows:

NOTICE: Government possession and control of the coal mines of this mining company have been terminated by order of the Secretary of the Interior.

Provided, however, That nothing contained herein shall be deemed to preclude the Government from requiring the submission of information relating to operations during the period of Government possession as provided in section 40 of the regulations for the operation of coal mines under Government control, as amended (8 F.R. 6655, 10712, 11344), for the purpose of ascertaining the existence and amount of any claims against the United States so that the administration of the provisions of Executive Order No. 9393 (8 F.R. 14877) may be concluded in an orderly manner; *And provided further,* That except as otherwise ordered, the appointment of the Operating Manager for the mines of the said Billman Coal Company shall continue in effect.

ABE FORTAS,
Acting Secretary of the Interior.

JANUARY 31, 1944.

[F. R. Doc. 44-1606; Filed, February 1, 1944; 12:04 p. m.]

FOREIGN ECONOMIC ADMINISTRATION.

ADOPTION OF RECOMMENDATIONS OF COMPLIANCE COMMISSIONER

MEMORANDUM OPINION

Pursuant to Part 807 of the Regulations, adopted under section 6 of the Act of July 2, 1940, as amended, the Trade Intelligence Division of the Office of Exports, Office of Economic Warfare (now Trade Intelligence Division of the Requirements and Supply Branch, Foreign Economic Administration) charged the respondent, Caldwell and Company, 50 Broad Street, New York, New York, with the violation of section 6 of the Act of July 2, 1940, as amended, and the regulations adopted pursuant thereto. After due notice the respondent requested an oral hearing in accordance with § 807.7 of said regulations. The matter came on for oral hearing before William B. Butz, Compliance Commissioner for the Office of Economic Warfare. Respondent appeared and was represented by counsel. Subsequent to the hearing the parties submitted briefs in the matter.

Compliance Commissioner Kelly Kash, who has succeeded to the position, reviewed the evidence presented and after due consideration of the record on the 20th day of January 1944 filed his findings of fact and recommendation in this matter. Said findings show that Caldwell and Company, 50 Broad Street, New York, New York is a corporation engaged in the business of representing other concerns as agent in matters involving exportation of commodities between various countries; that under date of April 24, 1942, respondent made application for license to export 389,440 pounds of iron wire and rods of an approximate value of $10,775.00 to Viuda de Juan Spreafico S. A., Monasterio 359, Buenos Aires, Argentina; that said application named Wickwire Spencer Steel Company as the "source of supply" for the commodity, Viuda de Juan Spreafico as ultimate consignee, and stated that the commodity was to be used for the manufacture of nails for various packing houses, that the consignor in the United States was New York Steel Exchange, Argentina; that under date of April 17, 1942, respondent received from New York Steel Exchange a communication referring to Order 4327 C. W. "Baviu"—Certificate of Necessity No. 779 and advising respondent that Certificate of Necessity was enclosed, requesting that export license be procured, and stating that the Steel Company would defray all expenses in connection with the matter; that License No. 1019860 covers the quantity of 389,440 pounds of hot rolled wire rods consigned to the Company, hereinafter called Spreafico, S. A.; that such license shows that the shipment was to be made pursuant to order dated February 11, 1942; that although the New York Steel Exchange actually made the order for 180 tons of wire rods to Spreafico, such shipment being covered by License 1019860, it appears from letter of September 9, 1943, from New York Steel Exchange to the Board of Economic Warfare that portions of the materials were shipped to consignees not named in the license and shipped on order of New York Steel Exchange; that at the time of the filing of license application by respondent there was a subsisting order for the shipment to Spreafico, the consignee mentioned in the license; that necessary letters of credit were furnished by New York Steel Exchange for use by Caldwell and Company for the procurement and shipment of the commodity covered by the license mentioned; that Shippers Export Declaration dated February 25, 1943, covering license 1019860 for 256,180 pounds of wire rod stated the value of the shipment as $8,499.00, that such shipment was for the account of New York Steel Exchange, Argentina and showed Spreafico as consignee; that Shipper's Bill of Lading No. 276 covering 256,180 coil steel wire rods shows the shipper as Caldwell and Company, Inc., agents, notice to be given to New York Steel Exchange, Argentina, and shows Spreafico as ultimate consignee; that the files and papers in connection with the various transactions referred to show respondent acted as agent either for New York Steel Exchange or the ultimate consignee and this was the limit of its interest; that New York Steel Exchange was not a consumer of the products herein referred to by a dealer; that in a communication dated March 1, 1943, respondent advised New York Steel Exchange that the 120 tons of wire rods heretofore mentioned had been shipped and was enroute to New Orleans for shipment to Argentina, that such shipment was not to be marked "Baviu"; that under date of February 21, 1942, Swiss Bank Corporation advised respondent that irrevocable credit had been opened in favor of respondent for account of New York Steel Exchange in the sum of $24,804.00; that by letter of August 9, 1943, License No. 1019860 was cancelled by the Office of Exports; that respondent certified that the difference in price quoted in the export declaration and that in the export license was a result of an increase in export expenses and was authorized by the Maximum Export Price Regulation, and that the increase in price was due to additional freight charges; that Bill of Lading No. 276 for the shipment of 256,180 pounds of coil steel wire to be delivered to "Order New York Steel Exchange, Argentina", was in connection with License No. 1019860, and that the Steel Company was not mentioned in this license; that failure to mention the Steel Company in such license is in violation of the regulations; that the price of steel as set forth in the export license represented the price at which Wickwire Spen-

cer Steel Company sold the steel to New York Steel Exchange; that in connection with the prices covering the shipment of 256,180 pounds of wire it is admitted by respondent that on instructions from New York Steel Exchange it drew up letters of credit for aggregate amounts in excess of the price paid to Wickwire Spencer Steel Company, but it is found that the excess amount represented charges for storage, handling and transportation; that in connection with the application for license filed on August 31, 1942, the names of the applicant, consignee, quantity of the commodity, and price were in substantial compliance with the Export Regulations; that said steel wire rods had been purchased for Spreafico as the ultimate consumer through negotiations carried on by the New York Steel Exchange; that the selling price of the steel was $10,774.90 f. a. s. New York, but the actual sale price to the consignee was in excess of this sum; that answers to questions 2, 6, 8 and 11 on said license application were not false and were not made with the intention to conceal the fact that the commodity was to be consigned to the New York Steel Exchange though such answers do not entirely comply with the Regulations; that respondent knew on or about February 11, 1942, the New York Steel Exchange had bought the steel in question from Wickwire Spencer Steel Company and that a credit would be established in the respondent's favor by New York Steel Exchange; that the fact that New York Steel Exchange was not named in the license application as consignor, but that respondent as agent was named, with the name of its principal not being disclosed, and the fact that the New York Steel Exchange, Argentina was not named as consignee were violations of the Export Regulations which require disclosure of the name of the real shipper and the real consignee. The Commissioner after having found that there have been violations of the Export Regulations has recommended that the suspension of license privileges of respondent since the date of the charging letter be deemed sufficient disciplinary action and that there be no further suspension of licensing privileges beyond January 20, 1944.

The undersigned having considered the findings and recommendations of the Compliance Commissioner has determined that the findings of fact are amply supported by the evidence and adopts the recommendation of the Compliance Commissioner that there be no suspension of licensing privileges beyond that date. *And it is so ordered.*

(Sec. 6, 54 Stat. 714; Pub. Law 75, 77th Cong.; Pub. Law 638, 77th Cong.; E.O. 9361, 8 F.R. 9861; Order 1, 8 F.R. 9938; E.O. 9380; 8 F.R. 13081; Delegation of Authority 20, 8 F.R. 16235; Delegation of Authority 21, 8 F.R. 16320)

Dated: January 29, 1944.

WALTER FREEDMAN,
Deputy Director,
Requirements and Supply Branch,
Bureau of Supplies.

[F. R. Doc. 44-1579; Filed, February 1, 1944; 9:42 a. m.]

OFFICE OF ALIEN PROPERTY CUSTODIAN.

[Vesting Order 2947]

EUGENE CIPRIANI

In re: Estate of Eugene Cipriani, also known as Gene Cipriani, deceased; File D-38-2835; E. T. sec. 8040.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation.

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by David Dotta, Administrator with the Will Annexed, acting under the judicial supervision of the District Court of the Fourth Judicial District of the State of Nevada, in and for the County of Elko;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Italy, namely,

Nationals and Last Known Address

Eugenia Cipriani, Italy.

Issue, names unknown, of Eugenia Cipriani, Italy.

Antonio Cipriani, Italy.

Issue, names unknown, of Antonio Cipriani, Italy.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Italy; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Eugenia Cipriani, issue, names unknown, of Eugenia Cipriani, Antonio Cipriani, and issue, names unknown, of Antonio Cipriani, and each of them, in and to the Estate of Eugene Cipriani, also known as Gene Cipriani, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC-1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 15, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44-1526; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 2948]

ELIZABETH M. RICHARDSON

In re: Trust under the will of Elizabeth M. Richardson, deceased; File D-66-497; E. T. sec. 3969.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by the Miners National Bank of Wilkes-Barre, Pennsylvania and Z. Platt Bennett, Co-trustees, acting under the judicial supervision of the Orphans' Court of Luzerne County, Pennsylvania;

(2) Such property and interests are payable or deliverable to, or claimed by, a national of a designated enemy country, Germany, namely,

National and Last Known Address

Gertrude H. Philippovich (nee Robinson), Germany (Austria).

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Gertrude H. Philippovich (nee Robinson) in and to the trust estate created under the will of Elizabeth M. Richardson, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order

may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 15, 1944.

[SEAL] LEO T. CROWLEY.
Alien Property Custodian.

[F. R. Doc. 44–1527; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 2967]

HENRY DRESES

In re: Trust under the will of Henry Dreses, deceased; File D–28–2120; E. T. sec. 2678.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by The Western Bank & Trust Company, S. E. Corner 12th & Vine Streets, Cincinnati, Ohio, and Mrs. Johanna Kahr Barnstorff, 505 Rollins Street, Columbia, Missouri, Co-Trustees, acting under the judicial supervision of the Probate Court of the State of Ohio, in and for the County of Hamilton;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Dietrich Dreses, Germany.
Mrs. Sophie Kahr, Germany.
Heinrich Dreses, Germany.
Mrs. Emma Kahr Kueper, Germany.
Georg Dreses, Germany.
Otto Dreses, Germany.
Mrs. Wilhelmine Kahr Oehmig, Germany.
Maria Wilms, Germany.
Mrs. Gretchen Dreses Steinbeck, Germany.
Wilhelm Dreses, Germany.
Frieda Dreses, Germany.
Mrs. Marie Dreses Griese, Germany.
Mrs. Emma Dreses Borgschulze, Germany.
Persons or persons, names unknown, child or children of Dietrich Dreses, Mrs. Sophie Kahr, Heinrich Dreses, Mrs. Emma Kahr Kueper, Georg Dreses, Otto Dreses, Mrs. Wilhelmine Kahr Oehmig, Maria Wilms, Mrs. Gretchen Dreses Steinbeck, Wilhelm Dreses, Frieda Dreses, Mrs. Marie Dreses Griese and Mrs. Emma Dreses Borgschulze, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Dietrich Dreses, Mrs. Sophie Kahr, Heinrich Dreses, Mrs. Emma Kahr Kueper, Georg Dreses, Otto Dreses, Mrs. Wilhelmine Kahr Oehmig, Maria Wilms, Mrs. Gretchen Dreses Steinbeck, Wilhelm Dreses, Frieda Dreses, Mrs. Marie Dreses Griese, Mrs. Emma Dreses Borgschulze and person or persons, names unknown, child or children of Dietrich Dreses, Mrs. Sophie Kahr, Heinrich Dreses, Mrs. Emma Kahr-Kueper, Georg Dreses, Otto Dreses, Mrs. Wilhelmine Kahr Oehmig, Maria Wilms, Mrs. Gretchen Dreses Steinbeck, Wilhelm Dreses, Frieda Dreses, Mrs. Marie Dreses Griese and Mrs. Emma Dreses Borgschulze, and each of them, in and to the trust created under the will of Henry Dreses, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 22, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1528; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 2968]

MARIE KOETTER

In re: Trust under the will of Marie Koetter, deceased; File D–28–2242; E. T. sec. 3295.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Northwestern National Bank of St. Louis, 1500 St. Louis Avenue, St. Louis, Missouri, Successor Trustee, acting under the judicial supervision of the Circuit Court of the State of Missouri, in and for the City of St. Louis;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Emma Issleib, Germany.
Edgar H. A. Issleib, Germany.
Otto C. F. Issleib, Germany.
Person or persons, names unknown, heirs and assigns of Edgar H. A. Issleib and Otto C. F. Issleib, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

The sum of $326.32 being net income in the process of administration by and in the possession and custody of the Northwestern National Bank of St. Louis, Trustee under the will of Marie Koetter, deceased; also,

All right, title, interest and claim of any kind or character whatsoever of Emma Issleib, Edgar H. A. Issleib, Otto C. F. Issleib and person or persons, names unknown, heirs and assigns of Edgar H. A. Issleib and Otto C. F. Issleib, and each of them, in and to the trust estate created under Clause 4 of the will of Marie Koetter, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 22, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1529; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 2969]

FRANK MAYLINGER

In re: Trust under the will of Frank Maylinger, deceased; File D–28–6470; E.T. sec. 3560.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by the First National Bank and Trust Company of New Haven, as Trustee, acting under the judicial supervision of the Court of Probate, District of New Haven, State of Connecticut;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely.

Nationals and Last Known Address

Auguste Maylinger Gresser, Germany.
Elizabeth Maylinger Pirner, Germany.
Johanna Maylinger Kaerlusohuntz, Germany.
Robert Maylinger, Germany.
Fritz Maylinger, Germany.
Johanna Willebacher, Germany.
Fritz Recktewald, Germany.
Anna Recktewald, Germany.
And the issue, whose names are unknown, of each of them, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive Order or Act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Auguste Maylinger Gresser, Elizabeth Maylinger Pirner, Johanna Maylinger Kaerlusohuntz, Robert Maylinger, Fritz Maylinger, Johanna Willebacher, Fritz Recktewald, Anna Recktewald and their issue, whose names are unknown, and each of them, in and to the trust created under the Will of Frank Maylinger, late of the Town of Hamden, State of Connecticut, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 22, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1530; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 2970]

PAULINE MCKINNON

In re: Estate of Pauline McKinnon, deceased; File D–66–496; E. T. sec. 3920.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian, after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by The San Francisco Bank, Executor, acting under the judicial supervision of the Superior Court of the State of California, in and for the County of Alameda;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Martha Tzechman, Germany.
Children, names unknown, of Martha Tzechman, Germany.
Alfred Walter, Germany.
Heinz Walter, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Martha Tzechman, Children, names unknown, of Martha Tzechman, Alfred Walter and Heinz Walter, and each of them, in and to the Estate of Pauline McKinnon, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 22, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1531; Filed, January 31, 1944; 11:19 a. m.]

[Vesting Order 2971]

ERNST WADEWITZ

In re: Estate of Ernst Wadewitz, deceased; File No. D–28–2420; E.T. sec. 3438.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by The First National Bank and Trust Company of New Haven, Executor, acting under the judicial supervision of the Court of Probate, District of New Haven, Connecticut;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany; namely,

Nationals and Last Known Address

Otto Keller, Zschoppach, Saxony, Frauendorf, Germany.
Marie Stecher, Leipnitz, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Otto Keller and Marie Stecher, and each of them, in and to the Estate of Ernst Wadewitz, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to

indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order, may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 22, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1532; Filed, January 31, 1944; 11:19 a. m.

[Vesting Order 2987]

JOSEPH BASLER

In re: Estate of Joseph Basler, deceased; File D–28–3754; E. T. sec. 6352.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Dennis Zimmermann, P. O. Box 577, Tulia, Texas, Independent Executor, and which is in "partition, libel, condemnation or other similar proceedings,"

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Katharina Hock, Germany.
Anna Basler, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever of Katharina Hock and Anna Basler, and each of them, in and to the estate of Joseph Basler, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1533; Filed, January 31, 1944; 11:19 a. m.]

[Vesting Order 2988]

CAROLINE A. GATTLE

In re: Estate of Caroline A. Gattle, deceased; File D–28–7583; E. T. Sec. 8010.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Frances Abelson, as Administratrix of the Estate of Henry Abelson, deceased, Executor under the will of Caroline A. Gattle, deceased, acting under the judicial supervision of the Surrogate's Court, New York County, State of New York;

(2) Such property and interests are payable or deliverable to, or claimed by, a national of a designated enemy country, Germany, namely,

National and Last Known Address

Dr. Lucy Adelsberger, Germany.

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Dr. Lucy Adelsberger, in and to the Estate of Caroline A. Gattle, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order, may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1534; Filed, January 31, 1944; 11:19 a. m.]

[Vesting Order 2989]

ANNA M. HANDRACK

In re: Estate of Anna M. Handrack, deceased; File D–28–1761; E. T. sec. 1022.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Andrew Abernethy, Jr., Executor of the estate of Anna M. Handrack, deceased, acting under the judicial supervision of the Union County Orphans' Court of Union County, New Jersey;

(2) Such property and interests are payable or deliverable to, or claimed by, a national of a designated enemy country, Germany, namely,

National and Last Known Address

Ida George, Germany.

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever of Ida George in and to the Estate of Anna M. Handrack, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1535; Filed, January 31, 1944; 11:20 a. m.]

[Vesting Order 2990]

ETHA D. KISSAM

In re: Trust under will of Etha D. Kissam, deceased; File D–11–17; E.T. sec. 3450.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order No. 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by the Fidelity Union Trust Company of Newark, New Jersey, Trustee, acting under the judicial supervision of the Essex County Orphans' Court of Newark, New Jersey;

(2) Such property and interests are payable or deliverable to, or claimed by, a national of a designated enemy country, Bulgaria, namely,

National and Last Known Address

Bogdana Palamidova Egnateff, Bulgaria.

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Bulgaria, and

Having made all determinations and taken all action, after appropriate consultation and certification required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Bogdana Palamidova Egnateff, in and to the trusts created under the will of Etha D. Kissam, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1536; Filed, January 31, 1944; 11:20 a. m.]

[Vesting Order 2991]

FERDINANDE LIPPOLD

In re: Estate of Ferdinande Lippold, deceased; File D–28–4340; E. T. sec. 7435.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Pauline Worm, as Administratrix, acting under the judicial supervision of the Surrogate's Court, New York County, New York;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Ignatz L. Lippold, Buhne, Westfalen, Kreis, Warburg, Germany.

Marie Ishen, Buhne, Westfalen, Kreis, Warburg, Germany.

Hedwig Krull, Buhne, Westfalen, Kreis, Warburg, Germany.

Joseph Krull, Buhne, Wetfalen, Kreis, Warburg, Germany.

Augusta Krull, Buhne, Westfalen, Kreis, Warburg, Germany.

Karl Krull, Buhne, Westfalen, Kreis, Warburg, Germany.

Willie Loeb, Buhne, Westfalen, Kreis, Warburg, Germany.

Karl Loeb, Buhne, Westfalen, Kreis, Warburg, Germany.

Werner Loeb, Buhne, Westfalen, Kreis, Warburg, Germany.

Elly Lippold, Buhne, Westfalen, Kreis, Warburg, Germany.

Terese Lippold, Buhne, Westfalen, Kreis, Warburg, Germany.

Hans Lippold, Buhne, Westfalen, Kreis, Warburg, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Ignatz L. Lippold, Marie Ishen, Hedwig Krull, Joseph Krull, Augusta Krull, Karl Krull, Willie Loeb, Karl Loeb, Werner Loeb, Elly Lippold, Terese Lippold and Hans Lippold, and each of them, in and to the Estate of Ferdinande Lippold, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1537; Filed, January 31, 1944; 11:20 a. m.]

[Vesting Order 2992]

MARCELLA NAGEL LUNDGREN, LILLIAN HELD, ET AL.

In re: Partition proceedings: Marcella Nagel Lundgren, Plaintiff, vs. Lillian Held, et al., Defendants; File D–28–1399; E. T. sec. 66.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Charles B. Walke, Sheriff of Butler County, Hamilton, Ohio, Depositary, acting under the judicial supervision of the Common Pleas Court of Butler County, Ohio;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Marie Baum Goehring, Germany.
Emilie Baum, Germany.
Theodore Baum, Germany.
Gretel Hoffman, Germany.
Emma Baum May, Germany.
Katherine Baum, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever of Marie Baum Goehring, Emilie Baum, Theodore Baum, Gretel Hoffman, Emma Baum May and Katherine Baum, and each of them, in and to the proceeds of the real estate sold in partition proceedings entitled "Marcella Nagel Lundgren, Plaintiff, vs. Lillian Held, et al., Defendants", being Case No. 51610 pending in the Common Pleas Court of Butler County, Ohio,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1538; Filed, January 31, 1944; 11:20 a. m.]

[Vesting Order 2993]

HELENE NAGEL

In re: Estate of Helene Nagel, deceased; File D–28–1531; E. T. sec. 165.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian, after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by J. P. Iverson, Executor, acting under the judicial supervision of the Superior Court of the State of California, in and for the County of San Joaquin;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Anna Oldehuus, Germany.
Reimer Johann Hinrich Paulsen and his descendants, Germany.
Wiebke Marie Paulsen and her descendants, Germany.
Anna Margaretha Paulsen and her descendants, Germany.
Paul Paulsen and his descendants, Germany.
Margreta Zech, Germany.
Anne Stempfle, Germany.
Maria Schwartz, Germany.
Auguste Nagel, Germany.
Anna Nagel, Germany.
Catherina Beckman, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Anna Oldehuus, Reimer Johann Hinrich Paulsen and and his descendants, Wiebke Marie Paulsen and her descendants, Anna Margaretha Paulsen and her descendants, Paul Paulsen and his descendants, Margreta Zech, Anne Stempfle, Maria Schwartz, Auguste Nagel, Anna Nagel and Catharina Beckman, and each of them, in and to the Estate of Helene Nagel, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1539; Filed, January 31, 1944; 11:20 a. m.]

[Vesting Order 2994]

IDA K. RUFF

In re: Trust under will of Ida K. Ruff, also known as Ida Katharina Ruff, deceased.

Under the authority of the Trading with the Enemy Act as amended, and Executive Order No. 9095 as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by The German Society of the City of New York, Trustee, acting under the judicial supervision of the Surrogate's Court of New York County, New York;

(2) Such property and interests are payable or deliverable to, or claimed by nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Emma Jetter, formerly Emma Ruff, Germany.
Elisabeth Kraft, formerly Elisabeth Ruff, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

having made all determinations and taken all action, after appropriate consultation and certification required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Emma Jetter, formerly Emma Ruff, and Elisabeth Kraft, formerly Elisabeth Ruff, and each of them, in and to the trust created under the last will and testament of Ida K. Ruff, also known as Ida Katharina Ruff, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of

the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1515; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 2995]

RUDOLF SCHULTZ

In re: Estate of Rudolf Schultz, deceased; File No. D–28–6584; E.T. sec. 5213.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interest hereinafter described are property which is in the process of administration by The German Society of the City of New York, as executor, acting under the judicial supervision of the Surrogate's Court, New York County, State of New York;

(2) Such property and interest are payable or deliverable to, or claimed by, a national of a designated enemy country, Germany, namely, Anna Schultz whose last known address is Germany;

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interest:

All right, title, interest and claim of any kind or character whatsoever of Anna Schultz, in and to the estate of Rudolf Schultz, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1516; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 2996]

FRIEDARIKA SENF

In re: Estate of Friedarika Senf, deceased; file D–28–3488; E.T. sec. 5579.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by C. Frederick Pertsch, Elizabeth Hussman, George Rusterholz, and Frederick Eiermann, Executors of the Estate of Friedarika Senf, deceased, acting under the judicial supervision of the Surrogate's Court, Nassau County, New York;

(2) Such property and interest as are payable or deliverable to, or claimed by a national of a designated enemy country, Germany, namely,

National and Last Known Address

Katharina S. Bender, Germany.

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever of Katharina S. Bender in and to the Estate of Friedarika Senf, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1517; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 3006]

ANNA BOOSS

In re: Estate of Anna Booss, deceased; File D–28–7829; E.T. sec. 8433.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Anna E. Williams, Administratrix, acting under the judicial supervision of the Orphans' Court of Baltimore City, Maryland;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Marta Moribs, Germany.
Helene Sander, Germany.
Margaret Bischoff, Germany.
Else Radewager, Germany.
Mina Buschow, Germany.
Henrich Kleiner, Germany.
Paul Becker, Germany.
Alfred Becker, Germany.
Anna Woitosky, Germany.
Emma Scholz, Germany.
Clara Schleicker, Germany.
Helene Tscharue, Germany.
Hedwig Becker, Germany.
Hildegarde Wetzel, Germany.
Clara Wetzel, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Maria Moribs, Helene Sander, Margaret Bischoff, Else Radewager, Mina Buschow, Henrich Kleiner, Paul Becker, Alfred Becker, Anna Woitosky, Emma Scholz, Clara Schleicker, Helene Tscharuc, Hedwig Becker, Hildegarde Wetzel and Clara Wetzel, and each of them, in and to the Estate of Anna Booss, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1518; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 3007]

GEORGE W. GERLICH

In re: Estate of George W. Gerlich, deceased; File D–28–2284; E. T. sec. 2875.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095 as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by the Fidelity Union Trust Company, Executor, of Newark, New Jersey, acting under the judicial supervision of the Essex County Orphans' Court of Newark, New Jersey;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Elizabeth Roth, Simbach–A Inn, Germany.

Matilde Roth Kathol, Fetter, Westfalen, Germany.

Josefine Roth Heimbach, Aschaffenburg Schlossgasse 10, Germany.

Anton Georg Gerlich, St. Andreasberg, Silberhuette 448 Kreis Zellerfeld, Germany.

Nicholas Gerlich, Wuerzbrug-Grombuehl, Gutenbergstrasse 10, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Elizabeth Roth, Matilde Roth Kathol, Josefine Roth Heimbach, Anton Georg Gerlich and Nicholas Gerlich, and each of them, in and to the estate of George W. Gerlich, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file, with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1519; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 3008]

ALFRED OSCAR KACHEL

In re: Estate of Alfred Oscar Kachel; File No. D–28–1779; E. T. sec. 972.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Anna Marie Kachel, Administratrix of the Estate of Alfred Oscar Kachel, deceased, acting under the judicial supervision of the Surrogate's Court of Nassau County, State of New York.

(2) Such property and interests are payable or deliverable to, or claimed by, a national of a designated enemy country, Germany, namely,

National and Last Known Address

Paul Kachel, Germany.

And determining that—

(3) If such national is a person not within a designated enemy country, the national interest of the United States requires that such person be treated as a national of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever of Paul Kachel in and to the Estate of Alfred Oscar Kachel, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1520; Filed, January 31, 1944; 11:16 a. m.]

[Vesting Order 3009]

AUGUSTA BECK

In re: Estate of Augusta Beck, deceased; File D–28–2453; E. T. sec. 3480.

Under the authority of the Trading with the Enemy Act as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by the Clerk of the Hudson County Orphans' Court, Depositary, acting under the judicial supervision of the Hudson County Orphans' Court of Hudson County, New Jersey;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Louise Wuensche, Germany.
Anna Seidel, Germany.
The Children, names unknown, of Anna Seidel, Germany.

And determining that—
(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest, and claim of any kind or character whatsoever, of Louise Wuensche, Anna Seidel and the Children, names unknown, of Anna Seidel and each of them in and to the estate of Augusta Beck, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1521; Filed, January 31, 1944; 11:17 a. m.]

[Vesting Order 3010]

NICHOLAS BIDDLE

In re: Trusts under the will of Nicholas Biddle, deceased; File No. D–28–1843; E.T. sec. 1454.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—
(1) The property and interests hereinafter described are property which is in the process of administration by the Bankers Trust Company, as trustee, acting under the judicial supervision of the Surrogate's Court, New York County, New York;
(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Ellen Biddle von Stackelberg, Germany.
Olaf Patrick von Stackelberg, Germany.
Elizabeth L. E. von Stackelberg, Germany.
Roderick von Stackelberg, Germany.
Nicholas T. von Stackelberg, Germany.

And determining that—
(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests;

All right, title, interest and claim of any kind or character whatsoever of Ellen Biddle von Stackelberg, Olaf Patrick von Stackelberg, Elizabeth L. E. von Stackelberg, Roderick von Stackelberg and Nicholas T. von Stackelberg and each of them in and to the trusts created under the Will of Nicholas Biddle, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian, a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1522; Filed, January 31, 1944; 11:17 a. m.]

[Vesting Order 3011]

IGNATZ GERENCSER

In re: Estate of Ignatz Gerencser, deceased; File 017–10463; D–28–7940; E. T.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation,

Finding that—
(1) The property and interests hereinafter described are property which is in the process of administration by Samuel Lowy, Executor, acting under the judicial supervision of the Orphan's Court of Lehigh County, Pennsylvania;
(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Frank Gerencser, (Austria) Germany.
Theresia Klepies, (Austria) Germany.

And determining that—
(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Frank Gerencser and Theresia Klepies and each of them in and to the Estate of Ignatz Gerencser, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1523; Filed, January 31, 1944; 11:17 a. m.]

[Vesting Order 3012]

MARIE KORNEFFEL

In re: Estate of Marie Korneffel, deceased; File 017–10463; D–28–7940; E. T. sec. 8717.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian, after investigation,

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Bertha Roggenkamp, Administratrix with the Will Annexed, acting under the judicical supervision of the Superior Court of the State of California, in and for the County of Los Angeles;

(2) Such property and interests are payable or deliverable to, or claimed by, nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Arthur Mehlhose, Germany.
Martha Korneffel, Germany.
Margarete Korneffel, Germany.
Charlotte Korneffel, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests:

All right, title, interest and claim of any kind or character whatsoever of Arthur Mehlhose, Martha Korneffel, Margarete Korneffel, and Charlotte Korneffel, and each of them, in and to the Estate of Marie Korneffel, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1524; Filed, January 31, 1944; 11:17 a. m.]

[Vesting Order 3013]

LUDWIG NISSEN

In re: Trusts under will of Ludwig Nissen, deceased; File No. D–28–2139; E. T. sec. 2727.

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order 9095, as amended, and pursuant to law, the Alien Property Custodian after investigation:

Finding that—

(1) The property and interests hereinafter described are property which is in the process of administration by Bankers Trust Company and Ferdinand W. Lafrentz, acting as surviving trustees, and Walter Eitelbach, acting as substituted trustee, acting under the judicial supervision of the Surrogate's Court for Kings County, New York; and

(2) Such property and interests are payable or deliverable to, or claimed by nationals of a designated enemy country, Germany, namely,

Nationals and Last Known Address

Fritz Ingwersen, Germany.
Marie Louise Pemoeller, Germany.
Katie Ingwersen Koch, Germany.
Hans Jonas Ingwersen, Germany.
Marie Caroline Frieda Ingwersen, Germany.
Carl Ingwersen, Germany.
Emmy Petersen, Germany.
Emmy Neddermeyer, Germany.
Julius Petersen, Germany.
Katie Eggers, Germany.
Nissen-Stiftung, Germany.
Armin Neddermeyer, Germany.
Walter Neddermeyer, Germany.
Rolf Wilhelm Otto Petersen, Germany.
Gerda Eggers, Germany.

And determining that—

(3) If such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country, Germany; and

Having made all determinations and taken all action, after appropriate consultation and certification, required by said Executive order or act or otherwise, and deeming it necessary in the national interest,

Now, therefore, the Alien Property Custodian hereby vests the following property and interests;

All right, title, interest and claim of any kind or character whatsoever of Fritz Ingwersen, Marie Louise Pemoeller, Katie Ingwersen Koch, Hans Jonas Ingwersen, Marie Caroline Frieda Ingwersen, Carl Ingwersen, Emmy Petersen, Emmy Neddermeyer, Julius Petersen, Katie Eggers, Nissen-Stiftung, Armin Neddermeyer, Walter Neddermeyer, Rolf Wilhelm Otto Petersen, and Gerda Eggers, and each of them, in and to the trusts created under the Will of Ludwig Nissen, deceased,

to be held, used, administered, liquidated, sold or otherwise dealt with in the interest of and for the benefit of the United States.

Such property, and any or all of the proceeds thereof, shall be held in an appropriate special account or accounts, pending further determination of the Alien Property Custodian. This shall not be deemed to limit the powers of the Alien Property Custodian to return such property or the proceeds thereof, or to indicate that compensation will not be paid in lieu thereof, if and when it should be determined that such return should be made or such compensation should be paid.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may file with the Alien Property Custodian a notice of his claim, together with a request for a hearing thereon, on Form APC–1, within one year from the date hereof, or within such further time as may be allowed by the Alien Property Custodian.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of said Executive order.

Dated: January 25, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1525; Filed, January 31, 1944; 11:18 a. m.]

[Vesting Order 1493, Amdt.]

PAUL MANTHEY

In re: First mortgage, insurance policies and a claim owned by Paul Manthey and others.

Vesting Order Number 1493, dated May 17, 1943, is hereby amended to read as follows:

Under the authority of the Trading with the Enemy Act, as amended, and Executive Order No. 9095, as amended, and pursuant to law, the undersigned, after investigation, finding:

1. That the last known address of Paul Manthey, August Manthey, Marie Schutte and Anna Koselke is Germany, and that they are residents of Germany and nationals of a designated enemy country (Germany);

2. That Paul Manthey, August Manthey, Marie Schutte and Anna Koselke are the owners of the property described in subparagraph 3 hereof;

3. That the property described as follows:

a. That certain mortgage recorded in the Register's Office of Kings County, New York, in Liber 6175 of Mortgages, page 260, which mortgage was assigned to Paul Manthey, August Manthey, Marie Schutte and Anna Koselke by an unrecorded assignment dated April 4, 1938, and any and all obligations secured by said mortgage, including but not limited to any and all collateral (including the aforesaid mortgage) for any and all such obligations and the right to enforce and collect such obligations, and the right to the possession of any and all notes, bonds or other instruments evidencing such obligations,

b. All right, title, and interest of Paul Manthey, August Manthey, Marie Schutte and Anna Koselke, and each of them, in and to fire insurance policy No. 621744, issued by The Hartford Fire Insurance Company of Hartford, Hartford, Connecticut, and covering the property subject to the mortgage described in subparagraph 3–a hereof, and

c. All right, title, interest and claim of any name or nature whatsoever of Paul Manthey, August Manthey, Marie Schutte and Anna Koselke, and each of them, in and to any and all obligations, contingent or otherwise and whether or not matured, owing to Paul Manthey, August Manthey, Marie Schutte and Anna Koselke, or any of them, by Richter & Kaiser, Inc., and represented on the books of Richter & Kaiser, Inc., as a credit balance due Paul Manthey, August Manthey, Marie Schutte and Anna Koselke, including but not limited to all security

rights in and to any and all collateral for any and all such obligations, and the right to enforce and collect such obligations,

is property within the United States owned or controlled by nationals of a designated enemy country (Germany);

And determining that the property described in subparagraphs 3–b and 3–c hereof is necessary for the maintenance or safeguarding of other property (namely, that property described in subparagraph 3–a hereof) belonging to the same nationals of the same designated enemy country and subject to vesting (and in fact vested by this order) pursuant to section 2 of said Executive order;

And further determining that to the extent that such nationals are persons not within a designated enemy country, the national interest of the United States requires that such persons be treated as nationals of a designated enemy country (Germany);

And having made all determinations and taken all action, after appropriate consultation and certification required by law, and deeming it necessary in the national interest,

hereby vests in the Alien Property Custodian the property described in subparagraph 3 hereof, to be held, used, administered, liquidated, sold or otherwise dealt with in the interest, and for the benefit, of the United States.

Such property, and any or all of the proceeds thereof shall be held in an appropriate account, or accounts, pending further determination of the Alien Property Custodian. This order shall not be deemed to limit the power of the Alien Property Custodian to return such property or the proceeds thereof in whole or in part, nor shall this order be deemed to indicate that compensation will not be paid in lieu thereof, if and when it should be determined to take any one or all of such actions.

Any person, except a national of a designated enemy country, asserting any claim arising as a result of this order may, within one year from the date hereof or within such further time as may be allowed, file with the Alien Property Custodian on Form APC–1 a notice of claim, together with a request for a hearing thereon. Nothing herein contained shall be deemed to constitute an admission of the existence, validity or right to allowance of any such claim.

The terms "national" and "designated enemy country" as used herein shall have the meanings prescribed in section 10 of Executive Order No. 9095, as amended.

Executed at Washington, D. C., on January 24, 1944.

[SEAL] LEO T. CROWLEY,
Alien Property Custodian.

[F. R. Doc. 44–1540; Filed, January 31, 1944; 11:21 a. m.]

OFFICE OF PRICE ADMINISTRATION.

[Order 15 Under Order A–2 Under MPR 188]

SIERRA TALC COMPANY

ORDER GRANTING ADJUSTMENT OF MAXIMUM PRICES

Order No. 15 under Order No. A–2 under Maximum Price Regulation No. 188. Manufacturers' maximum prices for specified building materials and consumers' goods other than apparel.

For the reasons set forth in an opinion, issued simultaneously herewith, and pursuant to paragraph (a) (10) of Order No. A–2 under § 1499.159b of Maximum Price Regulation No. 188, *It is hereby ordered,* That:

(a) Specific authorization is hereby granted to the Sierra Talc Company, Los Angeles, California, to sell, offer to sell, and deliver, and any person may buy, offer to buy, and receive, the following commodities set forth below:

	Sierra Fibrene	C–400
	Per ton	*Per ton*
To jobbers	$23.00	$24.00
To consumers	24.50	25.50

Terms of sale: Net, no discount required. All sales by Sierra Talc Company, Los Angeles, California are f. o. b. mill, Los Angeles, California.

(b) Any person purchasing Sierra Fibrene and C–400 from Sierra Talc Company may resell said commodities at prices not in excess of his established maximum prices therefore, adjusted upwards by an amount not in excess of his actual increase in cost resulting from the increases permitted to the Sierra Talc Company by virtue of paragraph (a) hereof.

(c) Second Revised Order No. 9 under Revised Supplementary Order No. 9, issued by this Office on November 6, 1943, is hereby revoked.

(d) Any person making sales subject to this order shall submit such reports to the Office of Price Administration as it may from time to time require, subject to the approval of the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

This Order No. 15 shall become effective February 1, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 31st day of January 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1567; Filed, January 31, 1944; 11:48 a. m.]

[Order 14 Under § 1499.19a of GMPR]

MUROC CLAY CO. ET AL.

ORDER AUTHORIZING ADJUSTABLE PRICING

Petitions have been filed by Muroc Clay Company, 5509 Randolph Street, Los Angeles, California; Vermont Talc Company, Chester Vermont; Georgia Talc Company, Asheville, North Carolina; Southern Talc Company, Asheville, North Carolina; and Western Carolina Talc Company, Asheville, North Carolina, for an amendment to Maximum Price Regulation No. 188, as amended, to increase the presently established maximum prices under that regulation for talc. This order shall be applicable only to the manufacturers herein specified.

It has been shown that authority to use adjustable pricing pending action on the petitions for amendment is necessary to promote the production and distribution of talc products and that such authority will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended, and Executive Orders Numbers 9250 and 9328. Therefore, in accordance with § 1499.19a of the General Maximum Price Regulation which is made a part of Maximum Price Regulation No. 188, as amended, by incorporation, *It is hereby ordered:*

(a) Pending final determination by the Office of Price Administration on the petitions for amendment now on file the above-specified manufacturers of talc and their dealers are hereby authorized to sell and deliver, and to offer to sell and deliver, talc at prices not in excess of the maximum prices established in accordance with Maximum Price Regulation No. 188 (for manufacturers) or the General Maximum Price Regulation (for dealers). *Provided however,* That offers to sell, sales, and deliveries may be made at prices adjustable to those resulting from final action taken by the Office of Price Administration upon the petitions for amendment now on file.

Manufacturers and dealers who avail themselves of the adjustable pricing authority permitted under this order may not receive and purchasers may not pay an amount in excess of maximum prices permitted by Maximum Price Regulation No. 188 or the General Maximum Price Regulation unless and until final action is taken by the Office of Price Administration establishing maximum prices in excess of those presently in effect.

(b) This order shall be automatically revoked upon the establishment by the Office of Price Administration of maximum prices for talc produced by the manufacturers described herein, higher than the maximum prices now prevailing, or upon denial of the petitions for amendment.

This order may be revoked or amended by the Price Administrator at any time.

This Order No. 14 shall become effective February 1, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of February 1944.

CHESTER BOWLES,
Administrator.

[F. R. Doc. 44–1602; Filed, February 1, 1944; 11:57 a. m.]

Regional and District Office Orders.

[Region I Order G–19 Under SR 15, MPR 280, and MPR 329, Amdt. 7]

FLUID MILK IN NEW HAMPSHIRE

Amendment 7 to Order G–19 Under § 1499.75 (a) (9) of Supplementary Regulation 15 to the General Maximum Price Regulation § 1351.807 of Maximum Price Regulation 280 and § 1351.408 of Maximum Price Regulation 329 (Formerly General Order 19).

For the reasons set forth in an opinion issued simultaneously herewith and under the authority vested in the Regional

Administrator of Region I of the Office of Price Administration by § 1499.75 (a) (9) of Supplementary Regulation 15 to the General Maximum Price Regulation, as amended, by § 1351.807 of Maximum Price Regulation No. 280, and § 1351.408 of Maximum Price Regulation No. 329; *It is hereby ordered,* That the title, the subdivisions designated as *Zone 3* and *Zone 4* in paragraph (b) (2), and subparagraphs (3) and (4) of paragraph (d), be amended, and that subparagraph (7) of paragraph (1) be added, to read as set forth below:

(b) * * *

(2) * * *

Zone 3—For the following Milk Marketing Areas:

(25)—Sanbornton, Gilford and Laconia; (59)—Northfield and Tilton; (34)—Franklin; (27)—Tuftonboro and Wolfeboro; (51)—Tamworth, Eaton, Madison, Freedom, Effingham and Ossipee; (19)—Conway, $3.72.

(23)—Milford, Amherst, Wilton; (71)—Merrimack; (79)—Brookline; (75)—Harrisville and Dublin; (41)—Winchester; (66)—Hillsborough; (42)—Goffstown; (61)—Allenstown and Pembroke; (81)—Rollinsford; (69)—South Hampton; (7)—Newfields and Newmarket; (13)—Farmington, $3.95.

(16)—Berlin and Gorham, $3.49.

Provided, further, That payments of differentials for butterfat content in excess of 3.7% are to be made in Area (16) on the basis of the calculations of the Federal Milk Marketing Administrator for Boston as announced from time to time by the New Hampshire Milk Control Board, as is now the customary practice throughout all other areas in the State of New Hampshire.

Zone 4—For the following Milk Marketing Areas, and the town of Hinsdale:

(17)—Lebanon; (30)—Hanover; (40)—Enfield, $3.49.

(11)—Bristol; (29)—Bridgewater and Hebron; (57)—Plymouth, Ashland and Holderness; (25A)—Alton, Moultonboro, Center Harbor, Meredith, New Durham; (28)—Gilmanton; (15)—Claremont; (73)—Newport, Sunapee and New London, $3.72.

(87)—Epping; (39)—Raymond; (18)—Peterborough; (50)—New Ipswich; (78)—Rindge; (49)—Greenville; and the town of Hinsdale, $3.95.

(d) * * *

(3) Zone 3 shall include:

#7—The Towns of Newmarket and Newfields.

#81—The Town of Rollinsford.

#69—The Town of South Hampton.

#51—The Towns of Ossipee, Effingham, Freedom, Madison, Eaton and Tamworth.

#19—The Town of Conway.

#16—The City of Berlin and the Town of Gorham.

#27—The Towns of Wolfeboro and Tuftonboro.

#25—The City of Laconia and the Towns of Sanbornton and Gilford and that part of Belmont which is within one mile of the shore of Lake Winnisquam, together with that part of Tilton between the Daniel Webster Highway and Lake Winnisquam.

#59—The Towns of Tilton and Northfield, exclusive of that part of Tilton heretofore included in Market Area #25.

#34—The City of Franklin.

#13—The Town of Farmington.

#61—The Towns of Pembroke and Allenstown.

#66—The Town of Hillsborough and that part of the Town of Deering which is within one mile of the Hillsborough-Deering Town Line.

#42—That part of the Town of Goffstown not included in Market Area #38, and that portion of the Village of Riverdale which is in the Town of Weare.

#41—The Town of Winchester.

#75—The Towns of Dublin and Harrisville.

#23—The Towns of Milford, Amherst and Wilton.

#71—The Town of Merrimack.

#79—The Town of Brookline.

(4) Zone 4 shall include:

#49—The Town of Greenville.

#87—The Town of Epping.

#39—The Town of Raymond.

#11—The Town of Bristol, exclusive of that part of the Town of Bristol, which is included in Market #29. (Newfound Lake Market Area.)

#29—The Towns of Hebron and Bridgewater and that part of Alexandria lying between the shore of Newfound Lake and an imaginary line parallel with and one-quarter mile westerly of the main road from Bristol to Hebron Village and that part of Bristol which lies between the western shore of said Lake and an imaginary line parallel with and one-quarter mile westerly from the main road from Bristol to Hebron Village. Also such part of Bristol which lies within one-quarter of a mile of the southern shore line of said Lake and also such part of Bristol within one-half mile of the easterly shore line of said Lake and all islands within said Lake.

#57—The Towns of Plymouth and Ashland and that part of the Town of Holderness as lies within three miles of the Plymouth-Holderness town line.

#18—The Town of Peterborough.

#50—The Town of New Ipswich.

#78—The Town of Rindge.

#25A—The Towns of Alton, Moultonborough, Center Harbor, Meredith and that part of the Town of New Durham which is more than one mile north of State Highway No. 11, and the Town of Holderness except such portion of said town as lies within three miles of the Plymouth-Holderness town line.

#28—The Town of Gilmanton.

#15—The Town of Claremont.

#73—The Towns of Newport, Sunapee and New London.

#40—The Town of Enfield.

#30—The Town of Hanover.

#17—The Town of Lebanon.

Not subject to any order of the N. H. Milk Control Board—Town of Hinsdale.

(1) * * *

(7) Amendment No. 7 shall become effective December 19, 1943, at 12:01 a. m.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871 and E.O. 9328, 8 F.R. 4681)

Issued this 16th day of December 1943.

K. B. BACKMAN,
Regional Administrator.

[F. R. Doc. 44-1563; Filed, January 31, 1944; 11:56 a. m.]

[Region VIII Order G-2 Under MPR 418, as Amended]

SMELT IN SAN FRANCISCO REGION

Order No. G-2 under Maximum Price Regulation No. 418, as amended. Fresh fish and seafood.

For the reasons set forth in an opinion issued simultaneously herewith and under the authority vested in the Regional Administrator of the Office of Price Administration by section 20 (a) of Maximum Price Regulation No. 418, as amended, *It is hereby ordered:*

(a) The maximum prices for sales of smelt (Eulachon or Thaleichthys Pacificus) in Region VIII of the Office of Price Administration shall be as follows:

	Name	Style of dressing	Size	Price in cents per pound	
				Bulk ex-vessel	Boxed
Table A: Producers	Smelt	Round	All	8¢	9½¢
Table B: Primary fish shipper sales	Smelt	Round	All	------	11¢
Table C: Retailer owner co-operative sales	Smelt	Round	All	------	12½¢
Table D: Cash & carry sales	Smelt	Round	All	------	13½¢
Table E: Service and delivery sales	Smelt	Round	All	------	16¢

(b) All other provisions of Maximum Price Regulation No. 418, as amended, shall be applicable to such sales unless the context clearly requires otherwise.

(c) *Definition of Region VIII.* "Region VIII" means the states of California, Washington, Nevada, Oregon, except Malheur and Harney Counties, and Arizona, except those portions of Coconino County and Mohave County lying north of the Colorado River; and the following counties in the state of Idaho: Benewah, Bonner, Boundary, Clearwater, Kootenai, Latah, Lewis, Nez Perce, Shoshone, and Idaho.

(d) This order may be revoked, amended or corrected at any time.

This order shall become effective January 25, 1944.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871 and E.O. 9328, 8 F.R. 4681)

Issued this 20th day of January 1944.

L. F. GENTNER,
Regional Administrator.

[F. R. Doc. 44-1574; Filed, January 31, 1944; 4:12 p. m.]

WAR PRODUCTION BOARD.

[Certificate 93,[1] Amdt. 2]

TRANSPORTATION OF ESSENTIAL MATERIALS

APPROVAL OF HAULAGE REQUEST TR-2

The ATTORNEY GENERAL:

Referring to Certificate No. 93, issued pursuant to section 12 of Public Law No. 603, 77th Congress (56 Stat. 357), on July 10, 1943, and to Amendment 1 thereto issued October 4, 1943, I submit herewith Haulage Request TR-2 of the War Production Board as amended today.[2]

For the purposes of the statute cited, I approve the amendment; and after consultation with you, I hereby find and so certify to you that the doing of any act or thing, or the omission to do any act or thing by any person in compliance with Haulage Request TR-2 as amended is requisite to the prosecution of the war.

DONALD M. NELSON,
Chairman.

JANUARY 29, 1944.

[F. R. Doc. 44-1581; Filed, February 1, 1944; 10:41 a. m.]

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[1] 8 F.R. 9730, 13696, 15648.

[2] *Infra.*

[Haulage Request TR–2, as Amended Jan. 29, 1944]

TRANSPORTATION OF ESSENTIAL MATERIALS

It is requisite to the prosecution of the war that the maximum amount of essential materials be delivered to essential war industries with a minimum dislocation of the general economy, with a minimum of delay and with a minimum of strain upon transportation facilities already severely taxed. This can best be accomplished through voluntary arrangements which permit materials to be consumed as near as may be to their source. Now, therefore, it is hereby requested that:

SECTION 1. *Purchases, sales, exchanges, and common use of facilities.* All persons engaged in producing, supplying or distributing the materials listed on Schedule X hereto annexed (herein referred to as "Schedule X materials"), may arrange for such purchases, sales, exchanges or loans of Schedule X materials and for such common use of transportation and storage facilities as may be requisite or necessary in order to attain the most efficient utilization of such facilities. All such arrangements shall remain subject to review and adjustment by the War Production Board to the end (1) that no producer, supplier or distributor of any Schedule X material shall be deprived of an opportunity to share equitably in the available supply of such material and the use of transportation and storage facilities, (2) that no consumer shall be inequitably treated in the distribution of Schedule X materials by reason of such arrangements, and (3) that such arrangements shall not go beyond the purpose and objective of this request.

SEC. 2. *Reports.* All persons who effect arrangements for purchases, sales, exchanges or loans of Schedule X materials and for common use of transportation and storage facilities, pursuant to section 1 hereof, shall inform the War Production Board thereof by letter, giving the following information:

1. Names and addresses of parties, including names and adresses of persons to whom inquiries concerning the report should be directed.

2. Effective date and duration of arrangement.

3. Kind and quantity of material involved.

4. Location of points of origin and destination of Schedule X materials to be shipped or location of storage facilities to be jointly used.

5. A statement that to the best of the informant's knowledge and belief, no supplier, distributor or producer of the material involved in the arrangement is or will be deprived by the arrangement of an opportunity to share equitably in the available supply and use of transportation and storage facilities.

6. A statement that to the best of the informant's knowledge and belief, no consumer of the material involved in the arrangement is or will be treated inequitably in the distribution of such material by reason of the arrangement.

A separate letter for each Schedule X material involved shall be filed, and if in furnishing the information called for by subparagraphs 3 and 4 above, the quantity of the material involved and the actual location of points of origin and destination or of storage facilities are estimated, supplemental information giving the exact, rather than the estimated, quantity and location, shall be furnished by letter to the War Production Board monthly throughout the duration of the arrangement. Further information may be specifically requested in particular cases.

SEC. 3. *Revocation of Transportation Request No. 1.* This request superseded and revoked Transportation Request No. 1 issued January 9, 1943,[1] covered by Certificate No. 27,[1] pursuant to Public Law No. 603, 77th Congress, but any action taken pursuant to the provisions of said Transportation Request No. 1 and said Certificate No. 27, prior to the date of the issue of this request (July 10, 1943), has the protection thereof.

SEC. 4. *Certification of this request.* Having consulted with the Attorney General, the Chairman of the War Production Board issued a certificate under section 12 of Public Law No. 603, 77th Congress (56 Stat. 357), with respect to this Haulage Request TR–2. (Certificate No. 93)

SEC. 5. *Communications.* All communications concerning this request and all information filed hereunder shall, unless otherwise directed, be addressed to: War Production Board, Washington (25), D. C., Reference TR–2 (Specify Material).

Issued this 29th day of January 1944.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

SCHEDULE X

1. Acetate: Amyl, butyl, ethyl, vinyl.
2. Acetic anhydride.
3. Acetone.
4. Acid: Acetic, citric, hydrochloric (muriatic), mixed (nitric and sulphuric), nitric, picric, sulphuric.
5. Adhesives.[1]
6. Alcohol: Amyl, butyl, diacetone, ethyl, isopropyl, methal (methanol).
7. Aluminum: Acetate, ammonium sulfate, chloride (anhydrous & crystals), formate potassium sulfate, sulfate.
8. Ammonia: Anhydrous and solutions.
9. Ammonium: Bicarbonate, carbonate, chloride (gray), nitrate (including fertilizer grades) sulfate.
10. Aniline.
11. Antifreeze preparations.
12. Butadiene.[1]
13. Calcium: Arsenate, carbide, chloride phosphates.

13a. Carbon bisulfide.[2]

14. Castor oil.
15. Caustic potash.
16. Caustic soda.
17. Cement (Portland cement).
18. Charcoal.[1]
19. Chemical cotton pulp and cotton linters.
20. Chlorinated hydrocarbons.
21. Chlorine.
22. Coal tars.
23. Coke.

23a. Containers,[2] fabricated (in knock-down or set-up form, whether assembled or unassembled). For the purpose of this item the word "containers" shall include all containers required for packaging products to be shipped or delivered, including, but not limited to: Bags, all types (including those made of paper, textile, combinations of materials, transparent films, metallic foils, parchment kraft or sulphite), baskets and hampers, cans (metal), collapsible tubes, cooperage, tight and slack, fibre cans, fibre tubes, fibre bottles, fibre mailing cases, and fibre drums, folding and set-up boxes (paperboard), gas cylinders, glass containers and closures, ice cream cans (paperboard) and paraffin cartons and pails, paper cups and paper food containers, paper milk containers, steel shipping drums, veneer and built-up wood (when used for containers), wooden and fibre inner containers, wooden and fibre shipping containers.

24. Copper sulfate.
25. Corn oil.
26. Corn syrup (glucose).
27. Cottonseed Oil.
28. Distillates and distillation residue of coal tars or coke oven crude light oils (including but not limited to benzol, creosote, cresol, cresylic acid, naphthalene, phenol, solvent naphtha, toluol, xylanol, and xylol).
29. Drugs, Medicine, Toilet Preparations and basic medicinal chemicals.
30. Formaldehyde.
31. Glycols.
32. Hydrogen Peroxide.
33. Lead Arsenate.
34. Lard and Lard Oil.
35. Lime and Limestone (including but not limited to fluxstone).
36. Linseed Oil.
37. Litharge.
38. Magnesium: Carbonate and Sulfate.
39. Methyl Ethyl Ketone.
40. Molasses.
41. Methyl Isobutyl Ketone.
42. Paint Driers, Solid and Liquid.
43. Paints, Varnish, Lacquers and Stains.
44. Peanut Oil.
45. Phosphorus.
46. Phthalic Anhydride.[1]

46a. Pig-Iron.[2]

47. Pigments, Colors and Extenders.
48. Plasticizers, Phosphate and Phthalate.
49. Potash Salts.

49a. Pulpboard,[2] viz: Boxboard, Chipboard, Newsboard, Paperboard, Paper stock board, Pulpboard, Strawboard.

50. Pyridine, Crude and Refined.
51. Pyrites.
52. Road Tar and Road Oil.
53. Sodium: Bicarbonate, Carbonate, Chlorate, Chloride, Hydroxide, Nitrate, Nitrite, Phosphates, Silicates, Sulfate, Pyrophosphate, Thiosulfate.
54. Solvents, Alcohol.
55. Solvents of Petroleum Origin.
56. Soyabean Oil.
57. Styrene.[1]
58. Superphosphates.
59. Tallow: Inedible and Edible.
60. Vegetable Oil Foots and Fatty Acids.
61. Water Gas Tar.

[1] Added to Schedule X as of October 4, 1943.
[2] Added to Schedule X as of January 29, 1944.

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[1] 8 F.R. 509.

[F. R. Doc. 44–1582; Filed, February 1, 1944; 10:41 a. m.]